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COMMENTS

Bankruptcy: The Sale of Property Under Section 363: The Validity of Sales Conducted Without Proper Notice

Introduction

The sale of property is an integral part of the administration of a bankruptcy estate.¹ As most commonly utilized, bankruptcy sales create cash proceeds which allow for the equitable and expeditious liquidation of an estate. Bankruptcy sales also play an important role in reorganizations by generating funds which help to maintain an ongoing business or individual estate. In both instances, the goal of a systematic reallocation of resources with a fresh start for the debtor rests firmly on the trustee's power of sale.²

Section 363³ of the Bankruptcy Code (the Code)⁴ provides the procedural framework and substantive provisions which regulate bankruptcy sales. Read in conjunction with the Bankruptcy Rules,⁵ this section provides procedural devices designed to protect those with an interest in the property being sold. One such device is the requirement that notice be given to all interested parties before a sale can be carried out. Therefore, in the absence of proper notice, a bankruptcy sale will not only be procedurally defective, but it may also violate an affected party's right to due process.

This comment first examines section 363 of the Code, focusing on the applicable notice requirements contained in the Bankruptcy Rules. Part II introduces the proper procedural guidelines to be followed when challenging a bankruptcy sale. Part III discusses the validity of a sale conducted without proper notice, presenting a survey of the different approaches taken by selected courts. Lastly, part IV considers the Tenth Circuit's probable treatment of a section 363 sale conducted without proper notice.

1. See Steven M. Shishko, *Selling Out Undersecured Creditors: "Value" Under Section 363(f) of the Bankruptcy Code*, 8 CARDOZO L. REV. 1151, 1151 (1987).

2. *Id.* at 1155.

3. 11 U.S.C. § 363 (1988). All references to a specified section hereinafter refer to those of Title 11 of the United States Code, unless otherwise provided.

4. The Bankruptcy Code, as utilized in this comment, refers to the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified at 11 U.S.C. §§ 101-1330 (1988)) (hereinafter referred to and cited as the Bankruptcy Code or Code). The predecessor to the Code is the Bankruptcy Act of 1898, Pub. L. No. 55-161, 30 Stat. 544 (repealed 1978) (hereinafter referred to and cited as the Bankruptcy Act or Act). Various sections of the Code were subsequently amended by the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333.

5. The Bankruptcy Rules, as adopted by the United States Supreme Court, became effective August 1, 1983. The Bankruptcy Rules govern the forms of process, writs, pleadings, motions, and procedure. Bankruptcy matters are also subject to local rules adopted by the bankruptcy courts for each judicial district, which vary from district to district, as well as to the local procedures established by the United States Trustee. They are cited as the Federal Rules of Bankruptcy Procedure. See RICHARD N. TILTON, *PURCHASE AND SALE OF ASSETS IN BANKRUPTCY CASES* § 3.17, at 69 (1984).

I. Section 363: Requirements and Application

A. An Overview

The trustee, debtor-in-possession, or chapter 13 debtor is granted broad powers pursuant to section 363 with respect to the use, sale, or lease of property of a bankruptcy estate.⁶ Under the pre-Code Bankruptcy Act, the provisions controlling the sale of property were codified in three separate sections, each corresponding to the three separate reorganization chapters then in existence.⁷ Because the Bankruptcy Act did not contain a unified provision similar to section 363, courts were forced to make decisions as to estate sales on a case-by-case basis, leaving an indefinite body of case law and providing little guidance to bankruptcy litigants.⁸ The promulgation of section 363 eliminated much of this uncertainty.

B. Who Can Sell Property Under Section 363

Property can be sold under section 363 in a chapter 7, 11, 12, or 13 proceeding.⁹ Thus, while section 363 speaks only in terms of a trustee,¹⁰ the Code

6. While § 363 speaks of the power to "use, sell, or lease" assets included in a bankruptcy estate, this comment is limited to a trustee's power of sale under that section. The sale of property under § 363 must be distinguished from the sale of property pursuant to the terms of a confirmed chapter 11, 12, or 13 plan. The latter type of sale is not governed by § 363 because unless otherwise provided in the plan, confirmation of a chapter 11 plan vests all property of the estate in the debtor. If such property is dealt with by the plan, it vests free and clear of all claims and interests of creditors, equity security holders, and general partners of the debtor. See 11 U.S.C. § 1141(b), (c) (1988).

7. See 11 U.S.C. §§ 116(3), 216(7) (1976) (repealed 1978) (chapter X); 11 U.S.C. § 363(2) (1976) (repealed 1978) (chapter XI); 11 U.S.C. § 413(2) (1976) (repealed 1978) (chapter XII). Bankruptcy sales conducted in cases commenced on or after October 1, 1979 are governed by the Code, while sales in cases commenced before October 1, 1979 continue to be governed by the Act. See TILTON, *supra* note 5, § 3.1, at 46.

8. See H.R. REP. NO. 595, 95th Cong., 1st Sess. 181-82 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6141-43; see also T.N. Ambrose, *The Sale of Assets from a Bankruptcy Estate*, 21 IDAHO L. REV. 583, 586 (1985).

9. Section 363 does not apply to a chapter 9 proceeding because there is neither an estate created nor a restriction placed on the use, sale, or lease of the debtor-municipality's property. See 2 COLLIER ON BANKRUPTCY ¶ 363.01, at 363-65 n.1 (Lawrence P. King ed., 15th ed. 1992) [hereinafter COLLIER]. Chapter 9 has its own provisions specifying which sections of the Code apply to that chapter. See 11 U.S.C. §§ 901-946 (1988). Chapter 12 was intended as a temporary provision for the adjustment of farm debts, legislated in response to the farm economic crisis of the mid-1980s. See *id.* §§ 1201-1231. Chapter 12 is scheduled to expire on October 1, 1998. Act of Oct. 27, 1986, Pub. L. No. 99-554, tit. III, § 302(f), 100 Stat. 3083, 3124, as amended by Act of Aug. 6, 1993, Pub. L. No. 103-65, § 1, 107 Stat. 311, 311: Due to the limited application of chapters 9 and 12, further discussion thereof will be omitted from this comment.

For ease of discussion, this comment assumes that all bankruptcy proceedings were filed voluntarily. While only voluntary proceedings may be filed under chapters 9, 12, or 13, involuntary proceedings may be commenced under chapters 7 or 11. See 11 U.S.C. §§ 101(17), 101(8), 303(a), 303(f) (1988). In an involuntary proceeding filed under § 303(f), § 363 does not apply until an order for relief has been entered. *Id.* § 303(f). As a result, the debtor may continue to sell assets of the estate as if no involuntary bankruptcy proceeding had been filed, unless the court orders otherwise. Sales conducted in this "involuntary gap" period may later be avoided to the extent that good value was not received for the assets under § 549. See *id.* § 549(a)(2)(A), (b); see also TILTON, *supra* note 5, § 3.23, at 78.

10. Although this comment speaks only in terms of a trustee, it is meant to include proceedings in

confers the same power of sale on a debtor-in-possession when appropriate.¹¹ This part outlines the power of sale under section 363 within each applicable chapter.

1. Chapter 7: Liquidation of an Estate

In a chapter 7 proceeding,¹² the trustee is given the responsibility of managing the bankruptcy estate. This includes liquidating property of the estate and distributing any available funds to creditors.¹³ Consequently, the chapter 7 trustee has the power, pursuant to section 363, to sell property of the estate when appropriate.¹⁴ However, an interim trustee must be appointed in a chapter 7 proceeding immediately upon the entry of an order for relief, serving until the election or designation of a trustee at the first meeting of creditors.¹⁵ The interim trustee possesses all of the powers and duties of a regular trustee, including the authority to sell property of the estate under section 363.¹⁶

If the chapter 7 bankruptcy estate includes a business, the trustee may continue its operation for a limited time in order to facilitate either the liquidation of assets or the sale of the business as a going concern.¹⁷ The operation of the business may continue so long as doing so is in the best interests of the estate and is consistent with the orderly liquidation of the estate.¹⁸

2. Chapter 11: Reorganization of a Business Estate

In a chapter 11 reorganization,¹⁹ the appointment of a trustee is not mandatory.²⁰ The debtor usually remains in control of the business estate,²¹ possessing

which a trustee is not appointed and the debtor remains in possession.

11. See *infra* notes 19-33 and accompanying text.

12. See 11 U.S.C. §§ 701-766 (1988). In a chapter 7 liquidation, all the assets of a bankruptcy estate will be sold except for general intangibles, which are sometimes converted to cash through collection. *Id.* §§ 721, 725. The purpose of this chapter is to reduce the debtor's nonexempt property to cash so that it may be fairly and expeditiously distributed to creditors. *Id.* § 726. In the case of an individual debtor, a fresh start is given through discharge. *Id.* § 727; see also *Burlingham v. Crouse*, 228 U.S. 459, 473 (1913) (stating that "it is the two-fold purpose of the Bankruptcy Act to convert the estate of the bankrupt into cash and distribute it among creditors and then give the bankrupt a fresh start").

13. See 11 U.S.C. § 704 (1988). See *supra* note 12.

14. See 11 U.S.C. §§ 721, 725 (1988).

15. See *id.* § 701(a), (b). In order to elect a trustee at the first meeting of creditors, at least 20% of the creditors, as determined by the amount of the allowable, undisputed, and unsecured claims, must request an election and actually vote. See *id.* § 702(b), (c). If a trustee is not elected, the court or the United States trustee appoints a trustee from a private panel of trustees. See *id.* § 701(a)(1).

16. See *id.* § 701(c).

17. See *id.* § 721; see also H.R. REP. NO. 595, *supra* note 8, at 380, reprinted in 1978 U.S.C.C.A.N. at 6336.

18. See 11 U.S.C. § 721 (1988).

19. See *id.* §§ 1101-1174. Chapter 11 provides a unified set of provisions for all types of reorganizations; usually for debtors engaged in business, but including individuals, partnerships, corporations, and a special subchapter for railroads. See *id.* §§ 101, 109(d), 1161-1174. The goal of this chapter is to rehabilitate a business as a going concern rather than to liquidate it. See *id.* § 1108. The debtor-in-possession is given a fresh start through the binding effect of the Order of Confirmation of the reorganization plan on all parties. See *id.* §§ 523, 1141(c).

20. See *id.* § 1104(a); see also H. REP. NO. 595, *supra* note 8, at 402, reprinted in 1978

most of the powers and duties of a trustee, unless the court, for cause shown, appoints a trustee.²² Included in these powers is the authority to sell estate assets under section 363.²³ However, if appointed, the chapter 11 trustee is empowered to conduct bankruptcy sales without the consent of the debtor, subject only to the restrictions imposed by section 363.²⁴

Under special circumstances, a trustee or debtor-in-possession may sell all of the property of the debtor's estate without converting the case to a chapter 7 proceeding.²⁵ In a chapter 11 "liquidating plan of reorganization," the court may approve the sale of all the estate's assets when such sale supports an articulated business justification or is otherwise in the best interest of the estate.²⁶ Under such a plan, the debtor is routinely authorized to remain in possession and operate the business. However, the court still retains the power to appoint a trustee to manage the bankruptcy estate if necessary.²⁷

U.S.C.C.A.N. at 6358; TILTON, *supra* note 5, § 7.2, at 109.

21. See 11 U.S.C. § 1108 (1988).

22. See *id.* §§ 1104(a)(1), 1108. A trustee may be appointed to operate the business, after notice and application to the court, upon any grounds set forth in § 1104. Such grounds include fraud, dishonesty, incompetence, and gross mismanagement of the affairs of the debtor, whether such acts occurred before or after the petition was filed. See *id.* § 1104(a)(1). If a trustee is appointed, a debtor may still be restored to possession. See *id.* § 1105. The debtor may also consent to the appointment of a trustee. See *id.* § 1104(a).

23. See *id.* §§ 1107, 1108; see also H. REP. NO. 595, *supra* note 8, at 404, reprinted in 1978 U.S.C.C.A.N. at 6360; S. REP. NO. 989, 95th Cong., 2d Sess. 116 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5902.

24. See 11 U.S.C. §§ 1106, 1108 (1988); see also TILTON, *supra* note 5, § 7.3, at 111.

25. Unlike its predecessor, the 1978 Code specifically allows a "liquidation plan" to be filed in a chapter 11 bankruptcy proceeding. See 11 U.S.C. § 1129(a)(7), (11) (1988). A liquidating plan of reorganization is subject to all the requirements of a regular chapter 11 proceeding, including a written plan of reorganization and a written disclosure statement. See *id.* §§ 1123, 1125(b). All parties must still be served with adequate notice and there must be a hearing to determine if all the requirements of the confirmed plan of reorganization have been met. See *id.* §§ 1125(b), 1128, 1129; FED. R. BANKR. P. 2002(b); see also Ambrose, *supra* note 8, at 594; John J. Hurley, *Chapter 11 Alternative: Section 363 Sale of All of the Debtor's Assets Outside a Plan of Reorganization*, 58 AM. BANKR. L.J. 233, 235 (1984); John C. Anderson et al., *Liquidating Plans of Reorganization*, 56 AM. BANKR. L.J. 29 (1982).

26. See, e.g., Committee of Equity Sec. Holders v. Lionel Corp. (*In re Lionel Corp.*), 722 F.2d 1063, 1071 (2d Cir. 1983) (stating that a chapter 11 debtor may in certain circumstances sell all or substantially all of his assets prior to the confirmation of a plan if evidence is presented that it is good business to do so); *In re Schlagen*, 91 B.R. 834, 838 (Bankr. N.D. Ill. 1988) (holding that the liquidation of substantially all of the property of the estate is a legitimate purpose of a chapter 11 case, and, therefore, a case should not be dismissed simply because the debtor contemplates a liquidating plan). But see Pension Benefit Guar. Corp., Continental Airlines, Inc. v. Braniff (*In re Braniff Airways, Inc.*), 700 F.2d 935, 940 (5th Cir. 1983) (holding that a proposed liquidating sale circumvented the disclosure requirements, had the practical effect of mandating provisions of a future plan of reorganization, and varied the priority distribution set forth in the Code); Foundry of Barrington Partnership v. Barrett (*In re Foundry of Barrington*), 129 B.R. 550, 556 (Bankr. N.D. Ill. 1991) (questioning the holding in *Schlagen*).

27. See *supra* note 22.

3. Chapter 13: Reorganization of an Individual Estate

In a chapter 13 proceeding,²⁸ a trustee is automatically appointed.²⁹ However, the debtor is usually allowed to retain possession of estate property, acting in a fiduciary capacity to the creditors while remaining subject to the supervision of the bankruptcy court.³⁰ If a debtor is engaged in a business, operation thereof may similarly continue, with the debtor retaining the power to sell property under section 363.³¹ Although a trustee may be appointed during a chapter 13 reorganization, the trustee has no inherent power to sell estate assets.³² The debtor is given the exclusive right to sell property under section 363.³³

C. Who Can Purchase Property Under Section 363

Any person, other than a trustee or officer of the court, can purchase property from a bankruptcy estate.³⁴ Consequently, a trustee of the immediate proceeding, as well as of an unrelated proceeding, is forbidden from purchasing estate property.³⁵ This ban also extends to employees of the trustee or persons assisting

28. See 11 U.S.C. §§ 1301-1330 (1988). Chapter 13 provides for the reorganization of an individual with regular income and unsecured debts of less than \$100,000, and secured debts of less than \$350,000. See *id.* § 109(e). Although relief under chapter 13 is not available to corporations or partnerships, a sole proprietor can file under chapter 13. See H.R. REP. NO. 595, *supra* note 8, at 318-20, *reprinted in* 1978 U.S.C.C.A.N. at 6275-77. This chapter is typically used to budget the debtor's future earnings under a plan through which creditors are paid in whole or in part over a three to five year period. See 11 U.S.C. § 1322(c) (1988). A fresh start comes from the discharge at the end of the case or payment plan, at which point the debtor is allowed to retain nonexempt assets. See *id.* § 1328. Note that the sale provisions under chapter 13 are limited to application in that section alone. See *id.* § 103(a).

29. See 11 U.S.C. § 1302 (1988); see also TILTON, *supra* note 5, § 3.3, at 51.

30. See 11 U.S.C. §§ 1303, 1304 (1988). While a trustee has a fiduciary duty to act with due diligence, the trustee is given discretion in making the business decisions involved in managing the estate and disposing of its assets, and will not be held liable unless it is clear that the discretion has been abused. This encourages trustees to diligently serve the estate's interests, while protecting trustees who have exercised their best business judgment in good faith. See, e.g., *Citicorp Acceptance Co. v. Ruti-Sweetwater (In re Sweetwater)*, 57 B.R. 354, 360 (D. Utah 1985) (stating that a debtor-in-possession has a duty to exercise reasonable judgement in conducting ordinary business matters, as well as a duty to use "good faith"); *Second Nat'l Bank of Nazareth v. Marcincin (In re Nadler)*, 8 B.R. 330, 334 (Bankr. E.D. Pa. 1980) (holding that the standard of care imposed on a bankruptcy trustee is one of diligence and skill as exercised by an ordinary prudent man in the conduct of his private affairs).

31. See 11 U.S.C. § 1303 (1988). The section provides: "Subject to any limitations on a trustee under this chapter, the debtor shall have, exclusive of the trustee, the rights and powers of a trustee under sections 363(b), 363(d), 363(e), 363(f) and 363(1), of this title." *Id.*; see also H. REP. NO. 595, *supra* note 8, at 427, *reprinted in* 1978 U.S.C.C.A.N. at 6383; TILTON, *supra* note 5, § 7.7, at 113.

32. See *supra* note 31.

33. See *supra* note 31.

34. See 18 U.S.C. § 154 (1988); see also TILTON, *supra* note 5, § 7.7, at 113.

35. The trustee is a fiduciary and must refrain from self-dealing with the estate. The trustee's good faith as well as the value of the property purchased is irrelevant, as this rule is designed to prevent even the appearance of impropriety. See TILTON, *supra* note 5, § 7.7, at 113; see, e.g., *Mosser v. Darrow*, 341 U.S. 267, 271 (1951) ("Equity tolerates in bankruptcy trustees no interest adverse to the trust. This is not because such interests are always corrupt but because they are always corrupting. By its exclusion of the trustee from any personal interest, it seeks to avoid such delicate inquiries as we have here into the

in the performance of the trustee's duties, such as an attorney, accountant, appraiser, or auctioneer.³⁶ Any prohibited person who knowingly purchases property from a bankruptcy estate, either directly or indirectly, is subject to criminal penalties.³⁷

The sale of a business' assets to its officers, directors, or other insiders under section 363 is not necessarily disallowed, but the sale will be strictly scrutinized.³⁸ Thus, while a sale to an employee having a fiduciary relationship with the debtor may sometimes be disallowed on equitable grounds, this prohibition does not extend to everyone employed by or related to the entity.³⁹ A business, or a portion of it, can therefore be purchased by those managing it at the time of a bankruptcy proceeding as long as the purchaser is not in a fiduciary position requiring unfailing loyalty, trust, or confidence.⁴⁰ If such an "inside" sale is proposed, all negotiations and transactions between the parties should be candid, fair, and equitable. The risk that the sale will later be challenged will be reduced if the appearance of impropriety is avoided.⁴¹

D. Property That Can Be Sold Under Section 363

Upon the filing of a bankruptcy petition, all the debtor's property, whether in actual or constructive possession, becomes property of the estate.⁴² However, before property can be sold under section 363, the trustee must establish that the debtor has a cognizable "legal or equitable ownership interest in the property at the commencement of the case."⁴³ Once this is determined, the trustee is authorized

conduct of its own appointees by exacting from them forbearance of all opportunities to advance self-interest that might bring the disinterestedness of their administration into question."); *In re Stephens & Co.*, 30 F.2d 725, 726 (D.C. Cal. 1928) ("The fact that a trustee does not regard such a transaction as improper is a strong indication that he has not the required mental makeup and attitude to qualify him as a trustee of a bankrupt estate, and that the best interests of the estate and of its creditors will not be conserved by his retention."); *In re Grodel Mfg.*, 33 B.R. 693, 694 (D. Conn. 1983) (stating it is well settled that trustees in bankruptcy occupy a fiduciary relationship with regard to the administration of estate assets).

36. See 11 U.S.C. § 327 (1988).

37. See 18 U.S.C. § 154 (1988); see also TILTON, *supra* note 5, § 7.7, at 113; Ambrose, *supra* note 8, at 585.

38. See TILTON, *supra* note 5, § 6.4, at 103; Ambrose, *supra* note 8, at 586.

39. See *supra* note 38.

40. *Id.*; see, e.g., *Jackson v. Pacific Energy Resources (In re Transcontinental Energy Corp.)*, 683 F.2d 326, 328 (9th Cir. 1982).

41. See TILTON, *supra* note 5, § 6.4, at 103.

42. See 11 U.S.C. § 541 (1988); see also 4 COLLIER, *supra* note 9, ¶ 541.04, at 541-22. The bankruptcy estate includes all tangible and intangible property in which the debtor has an interest upon the commencement of the proceeding. See 11 U.S.C. § 541(a) (1988). This even includes certain property acquired after filing, such as "[p]roceeds, offsprings, rents, or profits of or from property of the estate, except such earnings from services performed by an individual debtor after the commencement of the case." *Id.* § 541(a)(6).

43. See 11 U.S.C. §§ 363, 541(a)(1) (1988); cf. *Tambay Trustee, Inc. v. Dickman (In re Simicich)*, 71 B.R. 48, 50 (Bankr. M.D. Fla. 1987) (stating that chattels located on leased premises were to be leased with real property; no ownership interest passed to debtor); *Fandrich v. D & S Hydraulics Co. (In re Fandrich)*, 63 B.R. 250, 251-52 (Bankr. D.N.D. 1986) (reasoning that divorce decree left husband with

to retain possession of the property, utilizing it in the best interest of the estate.⁴⁴ Conversely, if the property is of no consequential value or benefit to the estate, it is usually abandoned.⁴⁵

Special restrictions on the sale of cash collateral are established in section 363(c)(2).⁴⁶ Cash collateral is broadly defined to include "cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents in which the estate and an entity other than the estate have an interest."⁴⁷ Due to the volatile nature of cash collateral and the inability of a bankruptcy court to protect creditors if this asset is improperly depleted, very strict and express rules have been established with regard to its sale.⁴⁸ The trustee is thus forbidden from selling cash collateral unless each entity having an interest in the asset consents, or if the court, after notice and a hearing, authorizes such action.⁴⁹

legal title only, so no sale free and clear of liens was possible); *Waldschmidt v. Johnson* (*In re Johnson*), 9 B.R. 14, 16 (Bankr. M.D. Tenn. 1981) (holding that rights of seller under unrecorded installment land contract are superior to those of buyer's trustee in bankruptcy).

44. See H.R. REP. NO. 595, *supra* note 8, at 345, *reprinted in* 1978 U.S.C.C.A.N. at 6301; S. REP. NO. 989, *supra* note 23, at 55, *reprinted in* 1978 U.S.C.C.A.N. at 5841. The Code also contains provisions requiring persons holding property of the estate which may be sold, used, or leased, to deliver such property to the trustee. See 11 U.S.C. §§ 542(a), 543(b) (1988).

45. See 11 U.S.C. § 554 (1988). *But see id.* § 362(d)(2)(A) (stating that a debtor may sometimes retain possession of property despite the lack of equity if it is necessary to a reorganization plan).

46. *Id.* § 363(c)(2). The subsection provides:

(2) The trustee may not use, sell, or lease cash collateral under paragraph (1) of this subsection unless--

(A) each entity that has an interest in such cash collateral consents; or

(B) the court, after notice and a hearing, authorizes such use, sale, or lease in accordance with the provisions of this section.

Id. Although a full discussion of this topic is beyond the scope of this comment, a brief introduction is necessary to distinguish cash collateral from the other categories of estate property routinely sold under § 363.

47. See *id.* § 363(a). The subsection provides in full:

(a) In this section, "cash collateral" means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents whenever acquired in which the estate and an entity other than the estate have an interest and includes the proceeds, products, offspring, rents, or profits of property subject to a security interest as provided in section 552(b) of this title, whether existing before or after the commencement of a case under this title.

Id. Note that the restrictions placed on cash collateral similarly apply to any such property created after the case is commenced. *Id.* Therefore, although inventory and receivables subject to a security interest are not cash collateral under this definition, any cash proceeds from these assets become cash collateral, whether collected before or after the filing of bankruptcy. *Id.*

48. See *id.* § 363(c)(2).

49. See *id.* § 363(c)(2); see also FED. R. BANKR. P. 4001(b) (governing the procedure to be followed in seeking authorization to use cash collateral).

E. Sales Conducted Under Section 363

Section 363 provides for two types of sales: those conducted in the ordinary course of business⁵⁰ and those conducted outside the ordinary course of business.⁵¹ While the differentiating factors between these two categories may seem obvious, the resulting practicalities, though not necessarily obvious, are significant.

For example, the sale of a home may qualify as either type, depending on who is the seller and the context in which the sale is made. If a professional home builder sells a house while involved in a bankruptcy proceeding, the sale would most likely occur within the ordinary course of business. However, if that same debtor's primary residence is sold in an extraordinary transaction, the sale would qualify as one conducted outside the ordinary course of business. The two sales, essentially similar, have entirely different legal ramifications under the Code.

1. The Sale of Property In the Ordinary Course of Business

The primary purpose behind section 363(c)(1)'s ordinary course of business rule is to aid in the smooth and efficient operation of a business during an ongoing bankruptcy proceeding.⁵² The trustee of an estate may generally sell property in the ordinary course of business without notice or a hearing⁵³ as long as the operation of the business has been authorized.⁵⁴ The business is thus allowed to

50. See *infra* note 52.

51. See *infra* note 64.

52. See 11 U.S.C. § 363(c)(1) (1988). The subsection provides:

(c)(1) If the business of the debtor is authorized to be operated under section 721, 1108, 1304, 1203, or 1204 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate, in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

Id. The power to deal with encumbered property in the ordinary course of business was first recognized in *Reconstruction Fin. Corp. v. Kaplan*, 185 F.2d 791 (1st Cir. 1950). See also *Committee of Asbestos-Related Litigants and/or Creditors v. Johns-Mansville Corp. (In re Johns-Mansville)*, 60 B.R. 612, 616 (Bankr. S.D.N.Y. 1986) (holding that ordinary course uses of estate property do not require prior hearing); *Armstrong World Indus., Inc. v. James A. Phillips, Inc. (In re James A. Phillips, Inc.)*, 29 B.R. 391, 394 (S.D.N.Y. 1983) (holding that where a debtor-in-possession is merely exercising the privileges of his status, there is no general right to notice and hearing concerning particular transactions conducted in the ordinary course of business).

53. See 11 U.S.C. § 363(c)(1) (1988). The lack of a notice and hearing requirement before a sale applies both in the case of general creditors as well as to parties with a security interest in the property. See 2 COLLIER, *supra* note 9, ¶ 363.01, at 363-23. The sale of such assets may continue only so long as the property interests of those concerned are adequately protected. See 11 U.S.C. § 363(e) (1988).

54. See 11 U.S.C. § 363(c)(1) (1988). The operation of a debtor's business must be authorized under §§ 721, 1108, 1304, 1203, or 1204 of the Code. In a chapter 7 liquidation, operation of a business is the exception; court authorization is required and is given only if it is in the best interest of the estate and consistent with the orderly liquidation thereof. See *id.* § 721. In a chapter 11 proceeding, the operation of the business is the rule and any limitation on business operations is the exception. See *id.* § 1108. In a chapter 13 proceeding, a self-employed debtor incurring trade credit in the production of income is considered to be engaged in business and may operate the business unless the court orders otherwise. See *id.* § 1304. All of these situations are still subject to the restrictions placed on the sale of cash

continue as a going concern, creating jobs, paying creditors, and providing shareholders with a return on their investment without incurring the burden of obtaining court approval, or notifying creditors, before every minor transaction.⁵⁵

The Code provides no concrete definition of "ordinary course of business." However, some guidance is offered in section 363(c)(1) which requires a level of continuity in the operation of the debtor's business. When making this determination, courts have typically applied one of two tests: the "vertical dimension" test or the "horizontal dimension" test.⁵⁶

Under the "vertical dimension" test, also referred to as the "creditor expectation" test, a court determines whether the proposed transaction exposes a creditor to an economic risk different from that which would have been accepted in the past.⁵⁷ If the transaction is within the day-to-day business of the debtor, it will be considered "ordinary."⁵⁸

The "horizontal dimension" test, however, involves a broader industry-wide perspective.⁵⁹ In order to be within the ordinary course of business under this test, the transaction of the debtor's business must reasonably approximate those transactions carried on in comparable businesses.⁶⁰

Section 363(c)(1) thus fosters the policy that the daily business of the debtor should not be disrupted by a notice requirement which results in more harm than benefit to the efficient functioning of a business.⁶¹ This works to protect the interests of all parties concerned as the bankruptcy estate is maintained through the continued operation of the business.⁶² The classification of a sale as one within the ordinary course of business can therefore be very valuable, working to greatly simplify the administration of a bankruptcy estate.

collateral. *See id.* § 363(a),(c)(4).

55. *See* H.R. REP. NO. 595, *supra* note 8, at 220, *reprinted in* 1978 U.S.C.C.A.N. at 6179.

56. *See* Burlington N. R.R. v. Dant & Russel, Inc. (*In re* Dant & Russel, Inc.), 853 F.2d 700, 704 (9th Cir. 1988) (providing a comprehensive discussion of both the horizontal and vertical dimension tests).

57. *See* Johnston v. First St. Cos. (*In re* Waterfront Co.), 56 B.R. 31, 34 (Bankr. D. Minn. 1985) (stating that "raising a crop would not be in the ordinary course of business for a widget manufacturer because that is not a widget manufacturer's ordinary business"); *Armstrong World Indus. v. James A. Phillips, Inc.* (*In re* James A. Phillips, Inc.), 29 B.R. 391, 394 (S.D.N.Y. 1983) (stating the touchstone of ordinariness is the interested parties' reasonable expectations of what transactions the debtor-in-possession is likely to enter in the course of business). *See supra* note 56.

58. *See* cases cited *supra* note 57.

59. *See, e.g.,* Committee of Asbestos-Related Litigants and/or Creditors v. Johns-Mansville Corp. (*In re* Johns-Mansville Corp.), 60 B.R. 612, 618 (Bankr. S.D.N.Y. 1986) (holding that increase in expenditures on lobbying and fluctuations in number of lobbyists retained did not render these activities extraordinary under the vertical dimension test; transactions need not be common, only ordinary within the industry).

60. *See id.* *See also supra* note 56.

61. *See supra* note 55.

62. *See supra* note 55. *See, e.g., In re* Selgar Realty Corp., 85 B.R. 235 (Bankr. E.D.N.Y. 1988) (stating that inherent in the ordinary course of business rule is the intent that the debtor maintain the value of the ongoing business while formulating a plan of recovery).

2. *The Sale of Property Outside the Ordinary Course of Business*

Any sale which cannot meet the criteria of a sale conducted in the ordinary course of business necessarily falls in the category of sales conducted outside the ordinary course of business. Not only do these sales include extraordinary business transactions, but commonly the sale of assets from an individual bankrupt's estate.⁶³

When contemplating sales outside the ordinary course of business, the trustee is guided by section 363(b)(1), which provides for the sale of property after proper notice and a hearing.⁶⁴ It is this requirement of notice and a hearing which stands as the most significant differentiating quality of a sale conducted outside the ordinary course of business.

a) *The "Notice and a Hearing" Requirement*

Section 363(b)(1) simply requires "notice and a hearing" before the trustee may sell property outside the ordinary course of business.⁶⁵ The purpose of this requirement is self-evident; it gives creditors and any other party with a vital interest in the property being sold the opportunity to review the terms of the proposed sale and to object if the terms and conditions are not in their best interest.⁶⁶ Because of the importance placed on each party's stake in the property

63. All sales outside the ordinary course of business may be by private sale or public auction. *See* FED. R. BANKR. P. 6004(f)(1). The rule provides:

(f) Conduct of sale not in the ordinary course of business

(1) Public or private sale

All sales not in the ordinary course of business may be by private sale or by public auction. Unless it is impracticable, an itemized statement of the property sold, the name of each purchaser, and the price received for each item or lot or for the property as a whole if sold in bulk shall be filed on completion of a sale. If the property is sold by an auctioneer, the auctioneer shall file the statement, transmit a copy thereof to the United States trustee, and furnish a copy to the trustee, debtor in possession, or Chapter 13 debtor. If the property is not sold by an auctioneer, the trustee, debtor in possession, or Chapter 13 debtor shall file the statement and transmit a copy thereof to the United States trustee.

Id. While bankruptcy sales may be conducted privately, a public auction is usually held because competitive bidding ensures that fair and valuable consideration is received, thus helping to avoid any suspicion of collusion or impropriety. Subject to the objections of a party in interest, the trustee may decide which type of sale is in the best interests of the estate. *See* Shishko, *supra* note 1, at 1152; *see also* 6 WILLIAM NORTON, JR., NORTON BANKRUPTCY LAW AND PRACTICE Rule 6005, at 313 (1984); *see, e.g.,* Zaccaro v. Bowery Sav. Bank (*In re Jewel Terrace Corp.*), 10 B.R. 1008, 1012 (E.D.N.Y. 1981) (stating that a public auction will generally be held unless the bankruptcy judge decides otherwise).

64. *See* 11 U.S.C. § 363(b)(1) (1988). The section provides: "The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate."

Id. Note that § 363(b)(1) was previously designated as 363(b), until amended by the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333.

65. *See supra* note 64.

66. *See* United Capital Corp. v. Sapolin Paints, Inc. (*In re Sapolin Paints, Inc.*), 11 B.R. 930, 936 (Bankr. E.D.N.Y. 1981); *see also In re Cavalieri*, 142 B.R. 710, 715 (Bankr. E.D. Pa. 1992) (stating there is no significant demarcation between secured and unsecured creditors as such a differentiation would

to be sold, even a single creditor has a sufficient interest to have a proposed sale reviewed, and if appropriate, denied.⁶⁷

"Notice and a hearing" is defined in section 102(1) as "such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances."⁶⁸ It must be emphasized, however, that an actual hearing is not necessarily required. As long as proper notice has been given, the court is free to authorize a sale under section 363(b)(1) without a hearing if there are no timely objections to the transaction, or if there is insufficient time to conduct a hearing.⁶⁹ This rule acts as an important device which separates the administrative and judicial functions of a bankruptcy judge, with such removal continuing so long as there are no disputes as to the proposed transaction.⁷⁰ This is a significant change from earlier bankruptcy law which required affirmative approval by the bankruptcy judge before virtually every transaction.⁷¹

When determining what is appropriate notice in the context of a bankruptcy sale, one is guided by two separate, yet integrated, provisions in the Bankruptcy

defeat the policy dictates of the code which is to ensure equitable treatment of all creditors); *Command Performance Operators, Inc. v. First Int'l Serv. Corp.* (*In re First Int'l Serv. Corp.*), 25 B.R. 66, 70 (Bankr. D. Conn. 1982) (stating the requirements of § 363(b) protect the creditors' interest in the estate). Although not the primary focus of this comment, notice also serves the important function of informing potential purchasers of the sale. *See infra* note 80 (notice to buyers).

67. *See infra* note 78.

68. 11 U.S.C. § 102 (1988). The section provides in pertinent part:

In this title--

(1) "after notice and a hearing", or a similar phrase--

(A) means after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances; but

(B) authorizes an act without an actual hearing if such notice is given properly and if--

(i) such a hearing is not requested timely by a party in interest; or

(ii) there is insufficient time for a hearing to be commenced before such act must be done, and the court authorizes such act

Id.; *see, e.g., M.R.R. Traders, Inc. v. Cave Atlantique, Inc.*, 788 F.2d 816, 819 (1st Cir. 1986) (stating that the measurement of adequate notice is determined in part by the circumstances of the case; this fits with the rule's literal language, provides fair procedure, and produces a more equitable sale); *see also* H.R. REP. NO. 595, *supra* note 8, at 345, *reprinted in* 1978 U.S.C.C.A.N. at 6301; S. REP. NO. 989, *supra* note 23, at 55, *reprinted in* 1978 U.S.C.C.A.N. at 5841.

Note that the requirement of proper notice may sometimes be satisfied constructively. Although constructive notice is not really notice as defined in the Code, it may work to satisfy the requirement and validate the sale in question. *See, e.g., In re Waipuna Trading Co.*, 41 B.R. 812, 814 (Bankr. D. Haw. 1984) (holding that attendance at a public auction constituted actual notice, thus waiving any objections thereto).

69. *See* 11 U.S.C. § 102(1)(B) (1988); FED. R. BANKR. P. 6004. If a hearing is not actually held, the sale is not a "judicial" sale. *See* 2 COLLIER, *supra* note 9, ¶ 363.03, at 363-18. *See infra* note 99.

70. *See* H. REP. NO. 595, *supra* note 8, at 315, *reprinted in* 1978 U.S.C.C.A.N. at 6272; S. REP. NO. 989, *supra* note 23, at 27, *reprinted in* 1978 U.S.C.C.A.N. at 5813; *see, e.g., In re Robert L. Hallamore Corp.*, 40 B.R. 181, 182-83 (Bankr. D. Mass 1984) (providing a succinct, yet comprehensive, discussion of the notice requirements for bankruptcy sales under rules 2002 and 6004).

71. *See* H. REP. NO. 595, *supra* note 8, at 315, *reprinted in* 1978 U.S.C.C.A.N. at 6272; S. REP. NO. 989, *supra* note 23, at 27, *reprinted in* 1978 U.S.C.C.A.N. at 5813.

Rules.⁷² Notice is generally required to be given pursuant to rule 2002,⁷³ with rule 6004⁷⁴ regulating the procedural aspects of such notice, or any objections thereto. These requirements for proper notice are relatively easy to satisfy; any difficulty usually arises in the determination of whether each party in interest⁷⁵ has in fact received notice.⁷⁶

Rule 2002(a) mandates that all parties in interest receive by mail at least twenty days' notice of a proposed sale.⁷⁷ The phrase "parties in interest" includes all creditors,⁷⁸ the debtor,⁷⁹ any prospective purchasers,⁸⁰ the United States trust-

72. Other Bankruptcy Rules are also implicated when discussing the notice requirements of a § 363 sale. These include rules 9006 and 9007, which authorize the court to regulate notice; rule 9007, which permits the court to designate the time, form, and manner of notice of matters not subject to rule 2002 or otherwise subject to specific rules; and rule 9008, which governs notice by publication as required under rule 2002. *See* FED. R. BANKR. P. 9006-9008; *see also* TILTON, *supra* note 5, § 3.17, at 69.

73. *See generally* FED. R. BANKR. P. 2002.

74. *See generally* FED. R. BANKR. P. 6004. Subsection (a) provides: "Notice of a proposed use, sale or lease of property, other than cash collateral, not in the ordinary course of business shall be give pursuant to rule 2002(a)(2), (c)(1), (i), and (k) and, if applicable, in accordance with § 363(b)(2) of the Code." *Id.*

75. *See infra* notes 77-82 and accompanying text.

76. To assure receipt of notice, a party in interest may file a notice of appearance and request for notice. If this is done, notice is required to be given to that party even if notice is generally limited pursuant to rule 2002(i). Members of the creditors' committee may also file requests for notice to assure that they receive direct notice in situations where notice would otherwise be given to counsel for the committee. *See* James B. Holden & Deborah D. Jones, *Representing Purchasers of Assets from Bankruptcy Estates*, 20 COLO. LAW. 2259 (1991).

77. FED. R. BANKR. P. 2002(a). The rule provides in pertinent part:

(a) Twenty-day notices to parties in interest

Except as provided in subdivisions (h), (i) and (1) of this rule, the clerk, or some other person as the court may direct, shall give the debtor, the trustee, all creditors and indenture trustees not less than 20 days notice by mail of

(2) a proposed use, sale, or lease of property of the estate other than in the ordinary course of business, unless the court for cause shown shortens the time or directs another method of giving notice

Id. While notice by publication in addition to notice by mail is not mandated, it is a good idea for larger sales where the rights of unknown creditors may be affected. *See* TILTON, *supra* note 5, § 14.4, at 189.

78. *See* FED. R. BANKR. P. 2002(a); *see, e.g.*, *United States v. Goodstein*, 883 F.2d 1362, 1366 (7th Cir. 1989), *cert. denied*, 494 U.S. 1007 (1990) (stating that before a court approves a § 363(b) transaction, notice must be provided to all creditors at least 20 days in advance, except in limited circumstances); *McLean Indus. v. Medical Lab. Automation, Inc. (In re McLean Indus.)*, 96 B.R. 440, 444 (Bankr. S.D.N.Y. 1989) (explaining that creditors must be given notice of a 363(b) transaction because they have an interest in whether the property of a debtor estate is sold, used or leased); *cf. Magnoni v. Globe (In re Globe Inv. & Loan Co.)*, 867 F.2d 556, 560 (9th Cir. 1989) (holding that a party must be a creditor at the time of sale to be entitled to notice).

79. *See* FED. R. BANKR. P. 2002(a); *see, e.g.*, *In re Upright*, 1 B.R. 694, 697 (Bankr. N.D.N.Y. 1979) (stating that an obligation to give notice of the sale of estate property other than in the ordinary course of business extends to debtor). Notice must be given to the debtor when a trustee has been appointed even though the debtor may lack standing to object to the sale due to the lack of a protectable interest. *See, e.g.*, *Willemain v. Kivitz*, 764 F.2d 1019, 1022-23 (4th Cir. 1985) (holding that a chapter 7 debtor did not have standing to challenge proposed sale of his primary asset).

80. Notice of a public sale may also be required to be given to a previous bidder or prospective purchaser even though the party may not be listed as a party in interest entitled to notice under applicable

ee,⁸¹ and others where applicable.⁸² With respect to persons having liens on property to be sold, prior notice is mandatory if the property is to be sold free and clear of the liens.⁸³

bankruptcy rule. *See, e.g., In re Times Sales Fin. Corp.*, 445 F.2d 385, 387-88 (3d Cir. 1971) (holding that the referee did not abuse her discretion in setting aside order of confirmation where original bidder was not notified of hearing for consideration of the proposed sale), *cert. denied*, 405 U.S. 917 (1972); *Felts v. Bishop (In re Winstead)*, 33 B.R. 408, 410 (M.D.N.C. 1983) (holding that a bidder was a party in interest and entitled to notice of hearing concerning sale of estate property).

81. *See* FED. R. BANKR. P. 2002(k). The rule provides:

(k) Notices to United States trustee

Unless the case is a Chapter 9 municipality case or unless the United States trustee otherwise requests, the clerk, or some other person as the court may direct, shall transmit to the United States trustee notice of the matters described in subdivisions (a)(2), (a)(3), (a)(5), (a)(9), (b), (f)(1), (f)(2), (f)(4), (f)(6), compensation or reimbursement of expenses. Notices to the United States trustee shall be transmitted within the time prescribed in subdivision (a) or (b) of this rule. The United States trustee shall also receive notice of any other matter if such notice is requested by the United States trustee or ordered by the court. Nothing in these rules shall require the clerk or any other person to transmit to the United States trustee any notice, schedule, report, application or other document in a case under the Securities Investor Protection Act, 15 U.S.C. § 78 et seq.

Id. This additional notice requirement was added in 1991 to help the United States trustee monitor the progress of the case in accordance with 28 U.S.C. § 586(a)(3)(G) (1988). *See* FED. R. BANKR. P. 6004 advisory comm. note.

82. *See, e.g.,* FED. R. BANKR. P. 2002(j). The rule provides:

(j) Notices to the United States

Copies of notices required to be mailed to all creditors under this rule shall be mailed (1) in a Chapter 11 reorganization case, to the Securities and Exchange Commission at any place the Commission designates, if the Commission has filed either a notice of appearance in the case or a written request to receive notices; (2) in a commodity broker case, to the Commodity Futures Trading Commission at Washington, D.C.; (3) in a Chapter 11 case to the District Director of Internal Revenue for the district in which the case is pending; (4) if the papers in the case disclose a debt to the United States other than for taxes, to the United States attorney for the district in which the case is pending and to the department, agency or instrumentality of the United States through which the debtor became indebted; or if the filed papers disclose a stock interest of the United States, to the Secretary of the Treasury at Washington, D.C.

Id.

83. 11 U.S.C. § 363(f) (1988). The subsection provides:

(f) The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if

(1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;

(2) such entity consents;

(3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;

(4) such interest is in bona fide dispute; or

(5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

Id.; *see also* FED. R. BANKR. P. 6004(c). The rule provides:

(c) A motion for authority to sell property free and clear of liens or other interests shall be made in accordance with Rule 9014 and shall be served on the parties who have liens or other interests in the property to be sold. The notice required by subdivision (a) of this

Notice of an upcoming sale must include "the time and place of a public sale, the terms and conditions of any private sale and the time fixed for filing objections" to the proposed transaction.⁸⁴ Such notice is deemed sufficient if it generally describes the property to be sold.⁸⁵

If cause is shown, the court may direct another method of giving notice or shorten the particular time limitations for responding to such notice.⁸⁶ This allows the court to accommodate the occasional need to act quickly in cases of exigency or emergency.⁸⁷ For example, even though notice is ordinarily required to be sent by mail,⁸⁸ notice by publication may be permitted where notice by mail is

rule shall include the date of the hearing on the motion and the time within which objections may be filed and served on the debtor in possession or trustee.

Id. Courts have traditionally recognized the right to sell encumbered property free and clear of existing liens. The premier case establishing this rule is *Ray v. Norseworthy*, 90 U.S. (23 Wall.) 128 (1874). Once notice has been properly administered, a sale can realistically be carried out free and clear of any liens or encumbrances on the property as long as any one of the § 363(f) requirements are satisfied. *See* 2 COLLIER, *supra* note 9, ¶ 363.07, at 363-32; *see also* H. REP. NO. 595, *supra* note 8, at 375, *reprinted in* 1978 U.S.C.C.A.N. at 6331; S. REP. NO. 989, *supra* note 23, at 90, *reprinted in* 1978 U.S.C.C.A.N. at 5876.

84. FED. R. BANKR. P. 2002(c)(1). The rule provides:

(c) Content of notice

(1) Proposed use, sale, or lease of property

Subject to Rule 6004 the notice of a proposed use, sale, or lease of property required by subdivision (a)(2) of this rule shall include the time and place of any public sale, the terms and conditions of any private sale and the time fixed for filing objections. The notice of a proposed use, sale, or lease of property, including real estate, is sufficient if it generally describes the property.

Id.

85. *Id.*

86. *See* FED. R. BANKR. P. 2002(a)(2); *see also* FED. R. BANKR. P. 2002(m). The rule provides: "The court may from time to time enter orders designating the matters in respect to which, the entity to whom, and the form and manner in which notices shall be sent except as otherwise provided by these rules." *Id.*; *see also* FED. R. BANKR. P. 9007. The rule provides:

General Authority to Regulate Notices

When notice is to be given under these rules, the court shall designate, if not otherwise specified herein, the time within which, the entities to whom, and the form and manner in which the notice shall be given. When feasible, the court may order any notices under these rules to be combined.

Id.

87. *See* FED. R. BANKR. P. 9006(b), (c); *see, e.g.,* *Armstrong World Indus. v. James A. Phillips, Inc.* (*In re James A. Phillips, Inc.*), 29 B.R. 391, 395-98 (S.D.N.Y. 1983) (affirming the bankruptcy court's order entered after only a few hours notice in an alleged emergency situation). However, the debtor should not be able to manufacture an emergency to deprive interested parties of an opportunity to be heard. *See, e.g., In re Sullivan Ford Sales*, 2 B.R. 350, 355-57 (Bankr. D. Me. 1980) (holding that irreparable or immediate injury would not result, either to debtor or reorganization effort, as a consequence of the brief delay occasioned by the need to provide appropriate advanced notice; debtor was not entitled to ex parte relief with respect to application).

88. *See* FED. R. BANKR. P. 2002(a); *see also* FED. R. BANKR. P. 2002(g). The rule provides:

(g) Addresses of notices

All notices required to be mailed under this rule to a creditor, equity security holder, or indenture trustee shall be addressed as such entity or an authorized agent may direct in a filed request; otherwise, to the address shown in the list of creditors or the schedule

impracticable due to the minimal value of the property or estate.⁸⁹ Additionally, in smaller chapter 7 liquidation cases, notice may be limited to creditors who have filed claims or are still entitled to do so.⁹⁰

Although section 102(1) provides for dispensing with a hearing in appropriate circumstances, there is no provision under the Code which allows for the elimination of the notice requirement altogether.⁹¹ Given this recognized importance, notice should only be dispensed with in the most unusual circumstances.⁹² Nevertheless, orders dispensing with notice are commonly granted when the period of delay associated with the required mailing of the usual notice will cause appreciable reduction in the value of the property or substantial prejudice to the

whichever is filed later. If a different address is stated in a proof of claim duly filed, that address shall be used unless a notice of no dividend has been given.

Id. If there are conflicting addresses between those originally supplied by debtor and creditor, then the address supplied by the creditor overrides, with the burden upon the interested party to see that any address changes are made known to the bankruptcy court. *Id.* The presumption that the addressee of properly addressed mail received the same is virtually irrebuttable. *See, e.g., Pelican Homestead v. Wooten (In re Gabel)*, 61 B.R. 661, 665 (Bankr. W.D. La. 1985) (stating that the presumption regarding the mailing of notice is an almost indispensable ingredient of the concept of finality as espoused in the notice and hearing requirements).

89. *See* FED. R. BANKR. P. 2002(f). The rule provides: "The court may order notice by publication if it finds that notice by mail is impracticable or that it is desirable to supplement the notice." *Id.*; *see also* FED. R. BANKR. P. 6004(d). The rule provides:

(d) Sale of property under \$2,500.00

Notwithstanding subdivision (a) of this rule, when all of the nonexempt property of the estate has an aggregate gross value less than \$2,500, it shall be sufficient to give a general notice of intent to sell such property other than in the ordinary course of business to all creditors, indenture trustees, committees appointed or elected pursuant to the Code, the United States Trustee and other persons as the court may direct. An objection to any such sale may be filed and served by a party in interest within 15 days of the mailing of the notice, or within the time fixed by the court. An objection is governed by rule 9014.

Id.; *see also* FED. R. BANKR. P. 9014. *See infra* note 95.

90. *See* FED. R. BANKR. P. 2002(h). The rule provides:

(h) Notices to committees

Copies of all notices required to be mailed under this rule shall be mailed to the committees elected pursuant to section 705 or appointed pursuant to foregoing subdivisions, the court may order that notices required by subdivision (a)(2), (3) and (7) of this rule be transmitted to the United States trustee and be mailed only to the committees elected pursuant to section 705 or appointed pursuant to section 1102 of the Code or to their authorized agents and to the creditors and equity security holders who serve on the trustee or debtor in possession and file a request that all notices be mailed to them. A committee appointed pursuant to section 1114 shall receive copies of all notices required by subdivisions (a)(1), (a)(6), (b), (f)(2) and (f)(7), and such other notices as the court may direct.

Id.

91. *See, e.g., In re Hanline*, 8 B.R. 449, 450 (Bankr. N.D. Ohio 1981) (stating that although a court order is not required before the trustee sells property, he must still comply with the "notice and a hearing" provision of § 363(b)). There was, however, a provision in the Act, § 58(a)(4), which allowed the court, upon cause shown, to order an immediate sale without notice. *See TILTON, supra* note 5, § 14.4, at 194.

92. *See TILTON, supra* note 5, § 14.4, at 194.

bankrupt estate.⁹³ A creditor's only remedy in such a case is to promptly object to the propriety of the sale or the procedures authorized therein.⁹⁴

b) Completing the Sale

Once notice of an impending sale has been received, any objections to the proposed transaction must be filed and served within five days before the proposed sale date, or within any other time period fixed by the court.⁹⁵ The objection should request a hearing and be served "on the person who is proposing to take the action; which would be either the trustee or debtor in possession," and anyone else specified in the notice of sale.⁹⁶

Upon objection, a hearing is held. If the court finds the objection unmeritorious, an order approving the sale and overruling the objection is appropriate.⁹⁷ The

93. See 9 AM. JUR. 2D *Bankruptcy* 1210 (1963). It is clear that a bankruptcy court has considerable discretion in determining when notice can be limited or denied to creditors. Moreover, because of the standards by which decisions are reviewed on appeal, a challenge of the bankruptcy court's decision is rarely successful unless actual harm can be shown. *Id.*; see also FED. R. BANKR. P. 2002(m).

94. See *infra* notes 103-51 and accompanying text.

95. See FED. R. BANKR. P. 6004(b). The rule provides:

(b) Objection to proposal

Except as provided in subdivisions (c) and (d) of this rule, an objection to a proposed use, sale, or lease of property shall be filed and served not less than five days before the date set for the proposed action or within the time fixed by the court. An objection to the proposed use, sale, or lease of property is governed by Rule 9014.

Id.; see also FED. R. BANKR. P. 9014. The rule provides in pertinent part:

In a contested matter in a case under the Code not otherwise governed by these rules, relief shall be requested by motion, and reasonable notice and opportunity for hearing shall be afforded the party against whom relief is sought. No response is required under this rule unless the court orders an answer to a motion. The motion shall be served in the manner provided for service of a summons and complaint by Rule 7004, and, unless the court otherwise directs, the following rules shall apply: Rule 7021, 7025, 7026, 7028-7037, 7041, 7042, 7052, 7054-7056, 7062, 7064, 7069, and 7071.

Id.

96. See TILTON, *supra* note 5, § 14.20, at 198; see also FED. R. BANKR. P. 9014.

97. See TILTON, *supra* note 5, § 14.20, at 198. An order authorizing a bankruptcy sale is similar to a basic motion in trial practice as it requests the court's approval of the contract with authorization to perform the contract. *Id.* § 14.17, at 196. Once an agreement has been reached and a written contract of purchase has been prepared and executed, the trustee prepares an application to the bankruptcy court for approval of the contract. The written application should include all the essentials relating to the sale, including the reasons for the sale and why the sale should be permitted. *Id.* Matters typically covered in the application include:

- (1) Description of the parties to the sale; (2) Relevant history of the debtor's case; (3) Background of the sale, including the number of parties contacted, brokers used and attempts to market and sell the property; (4) Description of the property being sold; (5) Summary of the purchase agreement, which may be attached as an exhibit; (6) Business reasons why the sale is in the best interests of the debtor, the estate, creditors and other parties in interest and should be approved; (7) Description of any related relief requested in prior proceedings or any prior applications to the court seeking similar judicial relief.

Id. The order should also contain any factual findings by the court which will reduce the likelihood or success of a collateral attack on the sale. *Id.* § 14.18, at 196. Note that even if a hearing is not requested, a prudent purchaser may wish to obtain a court order, or an order finding that notice was appropriate,

order should be entered after an evidentiary hearing which determines that proper notice has been given to all creditors, parties in interest, and other entities affected by the sale.⁹⁸

In the absence of a timely objection to a proposed sale, or after approval thereof, the trustee can proceed to close the sale with little court involvement.⁹⁹ The trustee must file with the court clerk an itemized statement of all property sold, accompanied by the name of the purchaser and the price received for each item, or the property as a whole.¹⁰⁰ If the property were sold at a public auction, the trustee must ensure that a similar report is filed by the auctioneer.¹⁰¹ Finally, the trustee must execute any legal instruments necessary to effectuate the transfer of property to the purchaser following the sale.¹⁰²

Both private and public auction sales can then be confirmed by the bankruptcy court.¹⁰³ Although it was a practice under the Bankruptcy Act to have all sales confirmed by the court, this requirement was eliminated under section 363(b)(1) when no objections are made.¹⁰⁴ Nevertheless, it is wise to have the sale confirmed, regardless of whether it may have been previously authorized, as confirmation has the effect of completing the sale, vesting full equitable title to the property in the purchaser.¹⁰⁵ This is true even though the executed deed may be irregular,

rather than a simple assurance that a sale is "authorized." *Id.*

98. *Id.*

99. Commentators agree that absent a dispute, there is no judicial involvement or court supervision of a sale conducted under § 363(b). See 2 COLLIER, *supra* note 9, ¶ 363.03, at 363-19; 1 NORTON, *supra* note 63, § 24.03, 145, n.1. See *supra* note 69. Because court intervention is limited, bankruptcy sales are usually nonjudicial sales. *Accord In re Canyon Partnership*, 55 B.R. 520, 524 (Bankr. S.D. Cal. 1985) (stating that sales under § 363 are not judicial sales as was the case under § 70 of the Bankruptcy Act); *Berg v. Scanlon (In re Alisa Partnership)*, 15 B.R. 802, 802 (Bank. D. Del. 1981) (stating a sale by trustee of property of estate is not a judicial sale). This classification may change, however, if the bankruptcy sale is ordered by the court rather than made as an election under § 363. The sale then becomes a judicial sale rather than an execution sale. See, e.g., *Governor's Island v. Eways (In re Governor's Island)*, 45 B.R. 247, 253 (Bankr. E.D.N.C. 1984) (maintaining a judicial sale is one by the court itself with the trustee or other officer conducting the sale, acting merely as the court's agent); *In re Hooten Enter.*, 21 B.R. 499, 501 (Bankr. N.D. Ala. 1982) (reasoning that a sale conducted through a proceeding in bankruptcy is a judicial sale as distinguished from an execution sale).

100. See FED. R. BANKR. P. 6004(f)(1).

101. *Id.*

102. See FED. R. BANKR. P. 6004(f)(2). The rule provides: "After a sale in accordance with this rule the debtor, the trustee, or debtor in possession, as the case may be, shall execute any instrument necessary or ordered by the court to effectuate the transfer to the purchaser." *Id.*

103. See *Gekas v. Pipin (In re Met-L-Wood Corp.)*, 861 F.2d 1012, 1016 (7th Cir. 1988) ("Actually the statute fails to define the court's role clearly, but the practice is that the bankruptcy judge, following the hearing, will issue an order authorizing the sale (if he decides the property should indeed be sold), and after the sale is made he will issue a second order, confirming the sale.").

104. See *In re Wall Tube & Metal Prods. Co.*, 56 B.R. 918, 924 (Bankr. E.D. Tenn. 1986); *In re Robert J. Hallamore Corp.*, 40 B.R. 181, 183 (Bankr. D. Mass. 1984) (where trustee's motion for approval of a sale was denied in absence of objection); cf. *Stearns v. Woolard (In re Laughinghouse)*, 51 B.R. 869, 873 n.2 (Bankr. E.D.N.C. 1985) (noting that the terms of a bankruptcy sale may require the court's confirmation; "[s]ales by trustees in this district are frequently made subject to court approval").

105. See *In re Gil-Bern Indus.*, 526 F.2d 627, 628 (1st Cir. 1975) (stating the highest bidder in

or even if there is no deed at all.¹⁰⁶ Most importantly, however, confirmation works to protect the debtor's estate by encouraging overall stability, and thus participation, in the bankruptcy sale process.¹⁰⁷

II. Challenging a Bankruptcy Sale

A bankruptcy court has broad powers which can be utilized to set aside a bankruptcy sale that is defective or inequitable in its procedure or effect. To take advantage of these powers, the sale must be directly attacked by either immediate appeal or post-judgment motion.¹⁰⁸

A. Appealing a Sale

Proper procedure must always be followed when appealing a bankruptcy sale.¹⁰⁹

judicial sale does not even have equitable title until sale is confirmed by the court); *In re Susquehanna Chem. Corp.*, 92 F. Supp. 917, 919-20 (W.D. Pa. 1950) (explaining that while a sales contract binds a purchaser, it does not generally complete a private sale; the sale is not consummated nor does title pass until confirmation); *In re Klein's Rapid Shoe Repair Co.*, 54 F.2d 495, 496-97 (2d Cir. 1931) (stating that confirmation completes a judicial sale, until which even an accepted bid makes a bidder no more than one whose proposal has been recommended).

106. *See, e.g., In re Todem Homes, Inc.*, 51 B.R. 883, 889 (Bankr. S.D.N.Y. 1985) (stating that confirmation completes a sale even if the deed executed in pursuance thereof is irregular, and even if no deed whatever is made).

107. *See, e.g., id.* (stating that the general policy of upholding regularly conducted sales becomes particularly important once a sale has been confirmed); *Gordon v. Woods*, 189 F.2d 76, 78 (1st Cir. 1951) (explaining that confirmation is designed to protect the bankrupt's estate by maintaining stability of judicial sales).

108. A bankruptcy sale can also be challenged by motion requesting an immediate review or rehearing of the court's original sale order. A motion for rehearing may be coupled with a motion under rule 9023 of the Bankruptcy Rules to amend the order or to amend or make further findings of fact and for a stay pending appeal. Although the court's findings of fact will not be set aside on appeal unless clearly erroneous, the appellant should still consider a motion pursuant to rule 7052 to amend findings of fact or to make further findings of fact in support of its grounds for appeal. Bankruptcy Rule 9014 makes rule 7052 applicable to contested matters such as objections to a proposed sale.

109. The Code provides three alternate routes for the appeal of a decision of the bankruptcy court. The basic route for an appeal from either an interlocutory or final orders is to a federal district court. *See* FED. R. BANKR. P. 8002(a); 28 U.S.C. § 1334 (1988). Further appeal is to the court of appeals. *See* 18 U.S.C. §§ 1293, 1294 (1988). The second route for appeal exists where the circuit court has created an appellate panel of three bankruptcy judges. *See* 28 U.S.C. § 160 (1988). The appeal then goes to the appellate panel. *See id.* § 1482. A third route exists where there is a final order of the bankruptcy court; if the parties to the appeal agree, the appeal may be taken directly to the court of appeals. *See id.* § 1293(b). A bankruptcy order is considered final when it "finally determines" one creditor's position, even if there is a contrary action in a bankruptcy court adversary proceeding. *See, e.g., Sandy Ridge Oil Co. v. Centerre Bank Nat'l Ass'n (In re Sandy Ridge Oil Co.)*, 807 F.2d 1332, 1334 (7th Cir. 1986); *In re Morse Elec. Co.*, 805 F.2d 262, 264 (7th Cir. 1986). Appeals from interlocutory orders may only be heard if leave to appeal is granted. FED. R. BANKR. P. 8001(a), 8003. Note that the appeals procedure may be modified by local rules pursuant to rule 8018, or suspended pursuant to 8019.

The appeals procedure, as specified in rules 8001 through 9019, must be strictly followed regardless of whether the court's initial approval of the sale was properly granted. *See, e.g., In re Sax*, 796 F.2d 994, 997-98 (7th Cir. 1986) (stating that § 363(m) only requires that the sale be authorized under § 363(b); not that the sale must be proper); *In re Wieboldt Store, Inc.*, 92 B.R. 309, 311 (N.D. Ill. 1988)

Rule 8001¹¹⁰ of the Bankruptcy Rules requires that an appeal from an order of a bankruptcy court be taken by filing notice of the appeal within the ten-day period allowed under rule 8002.¹¹¹ This ten-day period begins once the court issues an order authorizing the sale.¹¹² Notice of appeal should be filed with the clerk of the bankruptcy court¹¹³ and is deemed filed when received, not when mailed.¹¹⁴

(explaining that it matters not whether the authorization was correct or incorrect; the point is that procedure must be followed to challenge an authorization under § 363(b)).

The rules governing appeals discussed herein apply only to appeals to district courts or bankruptcy appellate panels. Subsequent appeals to the court of appeals, or direct appeals by agreement of the parties under 28 U.S.C. § 1293(b) (1988), are governed by Federal Rules of Appellate Procedure.

110. See FED. R. BANKR. P. 8001. The rule provides, in pertinent part:

(a) Appeal as of right; how taken

An appeal from a final judgment, order, or decree of a bankruptcy judge to a district court or bankruptcy appellate panel shall be taken by filing a notice of appeal with the clerk within the time allowed by Rule 8002. Failure of an appellant to take any step other than the timely filing of a notice of appeal does not affect the validity of the appeal, but is ground only for such action as the district court or bankruptcy appellate panel deems appropriate, which may include dismissal of the appeal. The notice of appeal shall conform substantially to the appropriate Official Form, shall contain the names of all parties to the judgment, order, or decree appealed from and the names, addresses and telephone numbers of their respective attorneys, and be accompanied by the prescribed fee. Each appellant shall file a sufficient number of copies of the notice of appeal to enable the clerk to comply promptly with Rule 8004.

(b) Appeal by leave; how taken

An appeal from an interlocutory judgment, order or decree of a bankruptcy judge as permitted by 28 U.S.C. section 158(a) shall be taken by filing a notice of appeal, as prescribed in subdivision (a) of this rule, accompanied by a motion for leave to appeal prepared in accordance with Rule 8003 and with proof of service in accordance with Rule 8008.

Id.

111. See FED. R. BANKR. P. 8002(a). The rule provides:

(a) TEN-DAY PERIOD. The notice of appeal shall be filed with the clerk within 10 days of the date of entry of the judgment, order, or decree appealed from. If a timely notice of appeal is filed by a party, any other party may file a notice of appeal within 10 days of the date on which the first notice of appeal was filed, or within the time otherwise prescribed by this rule, whichever period last expires. A notice of appeal filed after the announcement of a decision or order but before entry of the judgment, order, or decree shall be treated as filed after such entry and on the day thereof. If a notice of appeal is mistakenly filed with the district court or the bankruptcy appellate panel, the clerk of the district court or the clerk of the bankruptcy appellate panel shall note thereon the date on which it was received and transmit it to the clerk and it shall be deemed filed with the clerk on the date so noted.

Id.; see also FED. R. BANKR. P. 8003-8008.

112. See FED. R. BANKR. P. 8002(a). Because a sale can be upset, or at least stayed if an appeal is timely filed, a trustee would be acting prematurely to convey property prior to the expiration of the time allowed for an appeal. See *Felts v. Bishop (In re Winstead)*, 33 B.R. 408, 411 (M.D.N.C. 1983). If notice of appeal is not filed within the requisite period, the sale order becomes final, leaving any further challenges to be made through other equitable means. See *infra* text accompanying notes 130-51.

113. See FED. R. BANKR. P. 8002(a). It is important to note that notice must be filed with the clerk of the bankruptcy court and not with the clerk of the district court or appellate panel. *Id.*

114. *Id.*

Even if an appeal is timely filed, it will be dismissed as moot unless the appropriate stays are filed.¹¹⁵ Section 363(m)¹¹⁶ specifically provides that a sale authorized under section 363 will not be reversed or modified on appeal unless the authorization and/or sale are stayed pending appeal.¹¹⁷ Moreover, initiating the

115. See FED. R. BANKR. P. 8005, 8017. See *infra* notes 116-20 and accompanying text. The requirement of seeking a stay pending appeal applies regardless of whether the aggrieved party is challenging the validity of the court's authorization of the sale, the validity of the sale itself, or seeking only to obtain a refund of a portion of the purchase price. See, e.g., *Cargill, Inc. v. Charter Int'l Oil Co. (In re The Charter Co.)*, 829 F.2d 1054, 1056 (11th Cir. 1987), *cert. denied*, 485 U.S. 1014 (1988) (explaining that one cannot challenge validity of central element of a sale without challenging the validity of the sale itself; there is a flat rule governing all appeals of § 363 authorizations). An appeal from a judgment of the district court or bankruptcy appellate panel to the court of appeals is also subject to the requirement that a stay be obtained pending appeal. See FED. R. BANKR. P. 8017. See *supra* note 109.

116. See 11 U.S.C. § 363(m) (1988). Section 363(m) adopts the language of former FED. R. BANKR. P. 805 and provides in full:

The reversal or modification on appeal of an authorization under subsection (b) or (c) of this section of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith, whether or not such entity knew of the pendency of the appeal, unless such authorization and such sale or lease were stayed pending appeal.

Id.

117. See *id.* Section 363(m), which protects good faith purchasers of estate property, should be read in conjunction with rule 8005 relating to obtaining a stay pending appeal. Rule 8005 states the general procedural rules for obtaining a stay pending appeal, but it may be modified by local rules and by the practice of individual court judges or district court judges. See FED. R. BANKR. P. 8005. The rule provides in full:

A motion for a stay of the judgment, order, or decree of a bankruptcy judge, for approval of a supersedeas bond, or for other relief pending appeal must ordinarily be presented to the bankruptcy judge in the first instance. Notwithstanding Rule 7062 but subject to the power of the district court and the bankruptcy appellate panel reserved hereinafter, the bankruptcy judge may suspend or order the continuation of other proceedings in the case under the Code or make any other appropriate order during the pendency of an appeal on such terms as will protect the rights of all parties in interest. A motion for such relief, or for modification or termination of relief granted by a bankruptcy judge, may be made to the district court or the bankruptcy appellate panel, but the motion shall show why the relief, modification, or termination was not obtained from the bankruptcy judge. The district court or the bankruptcy appellate panel may condition the relief it grants under this rule on the filing of a bond or other appropriate security with the bankruptcy court. When an appeal is taken by a trustee, a bond or other appropriate security may be required, but when an appeal is taken by the United States or an officer or agency thereof or by direction of any department of the Government of the United States a bond or other security shall not be required.

Id.; see also *Anheuser-Busch, Inc. v. Miller (In re Stadium Mgmt. Corp.)*, 895 F.2d 845, 847-48 (1st Cir. 1990) (providing an informative discussion of the judiciary's treatment of the stay requirement and mootness doctrine); *Gelkas v. Pipin (In re Met-L-Wood Corp.)*, 861 F.2d 1012, 1018 (7th Cir. 1988), *cert. denied*, 490 U.S. 1006 (1989) (holding that even a reversal on appeal of an order authorizing or confirming a sale will not affect the sale's validity if the sale had not been stayed pending appeal); *Cargill, Inc. v. Charter Int'l Oil Co. (In re The Charter Co.)*, 829 F.2d 1054, 1056 (11th Cir. 1987), *cert. denied*, 485 U.S. 1014 (1988) (holding that a purchaser's appeal from a bankruptcy court order is rendered moot if that party fails to obtain a stay pending appeal); *In re Sax*, 796 F.2d 994, 997-98 (7th Cir. 1986) (stating that absent the posting of supersedeas bond, the appeal of an order will be dismissed as moot, provided the purchaser acted in good faith); *Willemain v. Kivitz (In re Willemain)*, 764 F.2d

motions discussed in this part does not automatically stay the court's order of sale. Therefore, absent appropriate action, the parties to the transaction may complete the sale.¹¹⁸

A stay is usually obtained through a direct motion to the bankruptcy court.¹¹⁹ However, because rule 8005 only requires that a motion for stay of an order of sale be presented to the issuing judge, there is no requirement that the motion be brought by an affected party.¹²⁰ As a result, virtually anyone, including a bankruptcy judge, has the power to initiate a stay. A bankruptcy judge can thus issue stays *sua sponte* whenever deemed necessary.¹²¹

However, a stay cannot be granted if it is apparent that irreparable harm will result from the operation of section 363(m) itself,¹²² or if the sale has already occurred leaving nothing to stay.¹²³ Stays are therefore usually granted only if a bond or other appropriate security is provided.¹²⁴

Despite its seemingly rigid application, section 363(m) maintains a certain degree of flexibility by relaxing its requirements when a purchase is not made in good faith. In such a case, an appeal will not be declared moot, even if a stay was not obtained, unless the property was purchased by a "good faith purchaser."¹²⁵

1019, 1023 (4th Cir. 1985) (explaining that regardless of whether a party had standing to object to a sale, the appeal is moot because the party failed to secure stay of approved sale pending appeal and because that interest was sold to a good faith purchaser); *Algeman, Inc. v. Advance Ross Corp.*, 759 F.2d 1421, 1423 (9th Cir. 1985) (stating that in the absence of a stay, the appeal is moot); *Tompkins v. Frey (In re Bel Air Assocs., Ltd.)*, 706 F.2d 301, 305 (10th Cir. 1983) (declaring that because a sale of property to a good faith purchaser cannot be set aside, a party appealing from an order authorizing the sale should always obtain a stay of the order); *In re Miami General Hosp., Inc.*, 81 B.R. 682, 689 (S.D. Fla. 1988) (dismissing appeal as moot where no stay pending appeal was sought or obtained); *Key Bank, N.A. v. IRS (In re Lake Placid Co.)*, 78 B.R. 131, 134-35 (W.D. Va. 1987) (declaring appeal moot where purchaser was good-faith purchaser and debenture holders failed to obtain a stay pending appeal).

118. See *supra* note 112.

119. See FED. R. BANKR. P. 8005. While a motion for stay must ordinarily be first made to the bankruptcy court, exceptions to this rule include the unavailability of the bankruptcy judge or the judge's previously stated intent to deny such motion. *Id.* While motions to the court are generally required to be in writing and to conform to local rules, as a part of the sale approval process, the bankruptcy judge may consider an oral motion for a stay in order to expedite matters. *Id.* Because the application for a stay is an expedited motion which must be obtained before the sale is completed, a motion for a stay to the appellate court is within the category of an emergency motion under rule 8011(d), to which special requirements apply. *Id.*; see also FED. R. BANKR. P. 8011 (establishing the general requirements for motions, including content and determination of motions).

120. See FED. R. BANKR. P. 8005.

121. *Id.*

122. See, e.g., *In re Baldwin United Corp.*, 45 B.R. 385, 386 (Bankr. S.D. Ohio 1984) (holding that where movants failed to establish that they would suffer irreparable injury if the stay pending appeal was not granted, and because the delay resulting from stay would harm debtors, movants were not entitled to stay).

123. See, e.g., *In re Dawkins & Assoc.*, 56 B.R. 691, 693 (Bankr. M.D. Fla. 1986) (explaining that a stay can not be granted when the sale has already occurred because there is nothing remaining to stay).

124. See FED. R. BANKR. P. 8005.

125. Although the term "good-faith purchaser" is not defined in either the Code or the Bankruptcy Rules, courts have construed the term in light of traditional equitable principles, defining it to mean one who purchases an asset in good faith and for value. The requirement that a purchaser act in good faith

Section 363(m) additionally provides that even after a sale has closed, an otherwise irreversible sale can be later attacked when it is shown that the purchase was not made in good faith.¹²⁶

Nevertheless, the rules governing an appeal of a section 363 sale are for the most part rigid and absolute, principally designed to further the judiciary's goal of maintaining finality in bankruptcy sales and integrity in judicial proceedings.¹²⁷ Without this stability, purchasers would likely demand a steep discount for their investment in property sold in bankruptcy sales.¹²⁸ Regardless, the inquiry into whether a bankruptcy sale can be rejected, or more appropriately, whether the purchaser is "home free," does not end with an examination of the appeals process.

speaks to the integrity of the purchaser's conduct in the course of the sale proceedings. *See, e.g.,* Willemain v. Kivitz (*In re Willemain*), 764 F.2d 1019, 1021 (4th Cir. 1985) (stating that a good faith purchaser is defined to mean "one who purchases the assets for value, in good faith, and without notice of adverse claims"); *see also In re Rock Indus. Mach. Corp.*, 572 F.2d 1195, 1198 (7th Cir. 1978). Misconduct that would destroy a purchaser's good faith status would be a sale involving fraud, collusion, or an attempt to take grossly unfair advantage of the trustee or other bidders. *But cf. In re Weiboldt Stores, Inc.*, 92 B.R. 309, 312 (N.D. Ill. 1988) (declaring that the lack of competitive bidding does not necessarily destroy the good faith of a sale). The second element of fair and valuable consideration is generally met in a bankruptcy proceeding if the purchaser pays at least 75% of the appraised value of the asset. *See e.g., In re Abbotts Dairies of Penn., Inc.*, 788 F.2d 143, 149 (3d Cir. 1986) (stating that generally speaking, an auction may be sufficient to establish that one has paid "value" for the assets of a bankrupt); *Greylock Glen Corp. v. Community Sav. Bank*, 656 F.2d 1, 4 (1st Cir. 1981) (holding that a buyer is generally deemed to have purchased for "value" when he pays at least 75% of appraised value of the asset); *see also In re Karpe*, 84 B.R. 926, 933 (Bankr. M.D. Pa. 1988); *cf. In re Pisces Leasing Corp.*, 66 B.R. 671, 673-74 (E.D.N.Y. 1986) (stating that a creditor who exchanges her secured claim for assets of the bankrupt plainly is paying "value" for those assets in the ordinary sense); *In re Youngstown Steel Tank Co.*, 27 B.R. 596, 599 (W.D. Pa. 1983) (holding that satisfaction of indebtedness is a purchase for value under § 363(m)); *Southerton Corp. v. United Penn. Bank (In re Southerton Corp.)*, 46 B.R. 391, 395-96 (D.C. Pa. 1982) (holding that a mortgage bank was a good faith purchaser of debtor's real property where the bank's outstanding judgment liens exceeding 75% of the property's purported value was discharged).

126. *See* 11 U.S.C. § 363(m) (1988).

127. *See, e.g., Onouli-Kona Land Co. v. Estate of Richards (In re Onouli-Kona Land Co.)*, 846 F.2d 1170, 1172 (9th Cir. 1988) (stating the mootness rule assures finality by protecting good faith purchasers); *Hoes Corp. v. Vetter Corp. (In re Vetter Corp.)*, 724 F.2d 52, 55 (7th Cir. 1983) (explaining that § 363(m) reflects salutary policy of not only affording finality to the judgment of the bankruptcy court, but particularly to give finality to those orders and judgments upon which third parties rely). *But see Sullivan Cent. Plaza, I, Ltd. v. BancBoston Real Estate Capital Corp. (In re Sullivan Cent. Plaza, I, Ltd.)*, 914 F.2d 731, 733-34 (5th Cir. 1990) (declaring that the primary reason for mootness doctrine is the lack of available relief, rather than finality).

128. *See, e.g., United States v. Salerno*, 932 F.2d 117, 123 (2d Cir. 1991) (explaining that upholding the terms of a bankruptcy sale furthers policy of finality; otherwise, potential buyers would discount their offers to the detriment of the bankruptcy estate); *In re Sax*, 796 F.2d 994, 998 (7th Cir. 1986) (stating finality is important because it minimizes the chance that purchasers will be dragged into endless roads of litigation to determine who has rights in the property, without which, purchasers would demand a steep discount for investing in the property); *Bleaufontaine, Inc. v. Roland Int'l (In re Bleaufontaine, Inc.)*, 634 F.2d 1383, 1389 n.12 (5th Cir. Unit B Jan. 1981) (stating it was the result of a policy determination that the integrity of the judicial sale process, upon which good faith purchasers rely, must be protected).

There are still additional equitable means which can be employed to upset the finality of a section 363 sale.¹²⁹

B. Equitable Alternatives to an Appeal: Applications to Vacate an Order of Sale

A bankruptcy court, sitting as a court of equity, has long been recognized as having the power to set aside its own orders.¹³⁰ The general rules governing the power to reconsider judgments within a reasonable time, including orders authorizing or confirming bankruptcy sales, are now found in rule 60(b) of the Federal Rules of Civil Procedure.¹³¹ Although courts recognized this judicial power long before the existence of rule 60(b),¹³² the fact that a final judicial order can now only be set aside under rule 60(b) leads to the conclusion that the old inherent power to reconsider bankruptcy orders has now been merged into this modern procedural rule.¹³³ Rule 60(b) is applied to cases under the Code by virtue of rule 9024 of the Bankruptcy Rules.¹³⁴

129. See *infra* notes 130-51 and accompanying text.

130. This equitable power was first expressed by the Supreme Court in *Wayne United Gas Co. v. Owens-Illinois Gas Co.*, 300 U.S. 131, 136-37 (1937), where the Court declared that a bankruptcy court, as a court of equity, has the power, for good reason, to revise its judgments on seasonable application and before rights have vested on the faith of the action. See also *Local Loan Co. v. Hunt*, 292 U.S. 234, 240 (1934) ("[C]ourts of bankruptcy are essentially courts of equity and their proceedings inherently proceedings in equity."); *Ross v. Kirschenbaum (In re Beck Indus., Inc.)*, 605 F.2d 624, 634 (2d Cir. 1979) ("We need not belabor the fact that a bankruptcy court, after all, is a court of equity."). However, the Supreme Court has made it clear that the power to set aside an order, and thus a sale, is limited. A bankruptcy court can reconsider and vacate its prior decisions so long as the proceedings have not terminated and no intervening rights have become vested which would be disturbed by the modification or reconsideration of the court's order. See *Wayne United Gas*, 300 U.S. at 136-37. One other significant limitation on a bankruptcy court's power to vacate its order arises when a notice of appeal is filed with a district court. Once an appeal is filed, the bankruptcy court loses jurisdiction along with any power to reconsider its prior decisions. See, e.g., *Bennet v. Gemmill (In re Combined Metals Reduction Co.)*, 557 F.2d 179, 200 (9th Cir. 1977) (stating a lower court should not be able to vacate or modify an order under appeal; even a bankruptcy court attempting to eliminate the need for the particular appeal); *Felts v. Bishop (In re Winstead)*, 33 B.R. 408, 409 (M.D.N.C. 1983) (holding the bankruptcy court erred in vacating an order of sale after notice of appeal was filed with the district court and jurisdiction over the subject matter of the appeal vested in the district court).

131. See generally FED. R. CIV. P. 60(b).

132. See 4B COLLIER ON BANKRUPTCY ¶ 70.98[17], at 1183-94 (Lawrence P. King ed., 14th ed. 1978) [hereinafter COLLIER, 1978 ED.].

133. See, e.g., *In re Met-L-Wood Corp.*, 861 F.2d 1012, 1018 (7th Cir. 1988), *cert. denied*, 490 U.S. 1006 (1989) (declaring that now that there is rule 60(b), expressly applicable to bankruptcy proceedings, the inherent power seems "otiose").

134. See FED. R. BANKR. P. 9024. The rule provides:

Rule 60 F.R.Civ.P. applies in cases under the Code except that (1) a motion to reopen a case under the Code or for the reconsideration of an order allowing or disallowing a claim against the estate entered without a contest is not subject to the one year limitation prescribed in Rule 60(b), (2) a complaint to revoke a discharge in a Chapter 7 liquidation case may be filed only within the time allowed by section 727(e) of the Code, and (3) a complaint to revoke an order confirming a plan may be filed only within the time allowed by section 1144, section 1230, or section 1330.

A motion under rule 60(b) must generally be brought within a reasonable time. This period begins after expiration of the ten-day period during which appeals are to be filed and ordinarily may not exceed one year after judgment was entered.¹³⁵ Rule 60(b), in application, may thus appear to be unduly harsh or unjust at times as valid claims can be summarily dismissed. However, a "time must come when a fair bid is accepted and the sale proceedings are concluded."¹³⁶ Preserving the finality and stability of bankruptcy sales is beneficial in that it encourages parties to bid at such sales.¹³⁷ This in turn benefits the estate, and in the end, all interested parties, as a higher price can be obtained for the property sold.¹³⁸

Although it is not clear from case law precisely what type or magnitude of fraud, mistake, or infirmity justifies setting aside a bankruptcy sale, rule 60(b) does enumerate certain scenarios in which a court can vacate its prior orders.¹³⁹ A "court may relieve a party . . . from a final judgment, order, or proceeding for the following reasons: (1) mistake, inadvertence, surprise, or excusable neglect; (2) newly discovered evidence . . . ; (3) fraud . . . , misrepresentation, or other misconduct of an adverse party . . . ; or . . . (5) . . . it is no longer equitable that the judgment should have prospective application"¹⁴⁰ A court may also base its decision to vacate an order confirming a sale under section 363 on rule 60(b)(4)

Id. Rule 9024 was originally issued as rule 924, effective October 1, 1973. At that time, there was uncertainty over the applicability of part (b) of rule 60 to bankruptcy proceedings. Rule 9024 eliminated this uncertainty. *See, e.g.,* Gekas v. Pipin (*In re Met-L-Wood Corp.*), 861 F.2d 1012, 1018 (7th Cir. 1988), *cert. denied*, 490 U.S. 1006 (1989) (stating that confirmed sales, as final judicial orders, can be set aside under rule 60(b), which is made applicable to bankruptcy proceedings by rule 9024 of the Bankruptcy Rules).

135. *See* Rule 60(b); *see also* 11 CHARLES A. WRIGHT & ARTHUR R. MILLER, *FEDERAL PRACTICE AND PROCEDURE* § 2866, at 228-31 (1973). *See supra* note 111. Motions under clauses (1), (2), or (3) must be made within a reasonable time, but not later than "one year after the judgment, order, or proceeding was entered or taken." *See* Rule 60(b); *see also* WRIGHT & MILLER, *supra*, § 2866, at 232. The reasonable time requirement is the only limitation on a motion under clauses (5) or (6). *See id.* § 2866, at 232. A motion brought under clause (4), attacking a judgment as void, has no time limitation. *See id.* § 2866, at 228. *See infra* notes 139-44 and accompanying text. If a petition to vacate a sale is viewed as an independent action, as permitted by 60(b), the doctrine of laches must be taken into consideration; any undue delay would support a finding of laches, thus rendering the petition moot. *See* WRIGHT & MILLER, *supra*, § 2868, at 239-45; *see, e.g.,* *In re Whitney-Forbes, Inc.*, 770 F.2d 692, 698 (7th Cir. 1985); *Simons v. United States*, 452 F.2d 1110 (2d Cir. 1971) (holding that four-year delay causing substantial prejudice to adverse party supported finding of laches).

136. *See In re Webcor, Inc.*, 392 F.2d 893, 899 (7th Cir.), *cert. denied*, 393 U.S. 837 (1968).

137. *See supra* note 128.

138. *See, e.g.,* Musi v. Nigro (*In re Homestead Indus., Inc.*), 138 B.R. 788, 790 (Bankr. W.D. Pa. 1992) (stating that judicial sales are to be accorded a substantial measure of finality in order to protect and encourage the process of selling estate assets).

139. *See* FED. R. CIV. P. 60(b).

140. *Id.*; *see also In re Whitney-Forbes, Inc.*, 770 F.2d 692, 696 (7th Cir. 1985) (discussing rule 60(b) and the reasons justifying a court in relieving a party of a judgment, order, or proceeding); *In re Webcor, Inc.*, 392 F.2d 893, 899 (7th Cir.) (declaring that a confirmed sale will be set aside only in cases of fraud, accident, mistake, or other defect which is of such magnitude as to "shock the conscience of the chancellor"), *cert. denied*, 393 U.S. 837 (1968); *see also* *Lamont v. Grass (In re Lamont)*, 453 F. Supp. 608, 609-10 (N.D.N.Y. 1978), *aff'd*, 603 F.2d 213 (2d Cir. 1979).

which allows relief where "the judgment is void."¹⁴¹ Lastly, relief from a judgment is also available under rule 60(b)(6) when there is "any other reason justifying relief from the operation of the judgment."¹⁴² Subsection (b)(6), viewed by some as a "catch-all," grants a court liberal power to vacate orders and is restricted by no time limitation.¹⁴³ However, in most cases a sale is only vacated under rule 60(b)(6) when "compelling equities" outweigh the general policy of finality.¹⁴⁴

Courts will ordinarily refuse to set aside a bankruptcy sale based on a minor defect. Instead, a combination of defects having a tendency to indicate unfairness or impropriety is normally required before a sale will be vacated.¹⁴⁵ While a bankruptcy sale may be defective in many ways, defects warranting that a sale be set aside arise infrequently, and typically involve irregularities in bankruptcy sale proceedings themselves. Examples include "unfairness toward bidders, stifling of competition, inaccurate or otherwise insufficient advertisement, sham bidding or interference with the orderly conduct of the sale."¹⁴⁶

141. See 11 WRIGHT & MILLER, *supra* note 135, § 2862, at 197-200; see also C.K.S. Eng'rs, Inc. v. White Mountain Gypsum Co., 726 F.2d 1202, 1205 (7th Cir. 1984) (stating that relief under rule 60(b)(4) should be granted only under exceptional circumstances); Margoles v. Johns, 660 F.2d 291, 295 (7th Cir. 1981), *cert. denied*, 455 U.S. 909 (1982) (stating sales are usually void as a result of lack of subject matter jurisdiction or jurisdiction over the parties, or when the court acts in a manner inconsistent with the due process of law).

142. See FED. R. CIV. P. 60(b)(6).

143. See *infra* note 135. See, e.g., Pioneer Inv. Serv. Co. v. Brunswick Assocs. Ltd. Partnership, 113 S. Ct. 1489, 1497 (1993) (stating that rule 60(b)(6) empowers the court to reopen a judgment even after one year has passed).

144. See, e.g., Pantoja v. Texas Gas & Transmission Corp., 890 F.2d 955, 960 (7th Cir. 1989), *cert. denied*, 497 U.S. 1024 (1990) (maintaining that relief under the "catch-all" exception of rule 60(b)(6) should only be employed in the most extraordinary of circumstances); Backlund v. Barnhart, 778 F.2d 1386, 1388 (9th Cir. 1985) (stating that a rule 60(b)(6) motion requires a showing of extraordinary circumstances; must be for some reason other than the five reasons preceding it under the rule 60(b)); Jackson v. Pacific Energy Resources (*In re Transcontinental Energy Corp.*), 683 F.2d 326, 328 (9th Cir. 1982) (stating a bankruptcy sale is properly set aside under rule 60(b)(6) when compelling equities outweigh interest in finality). *But cf. In re Times Sales Fin.*, 445 F.2d 385, 387 (3d Cir. 1971), *cert. denied*, 405 U.S. 917 (1972) (holding that "innocent mistake" had occurred, and "common decency" required relief under rule 60(b)(6), which allows relief when "just"); Commonwealth v. Durkalec (*In re Durkalec*), 21 B.R. 618, 619 (Bankr. E.D. Pa. 1982) (stating that rule 60(b) is applicable whenever necessary to accomplish justice).

145. See e.g., *In re Chung King, Inc.*, 753 F.2d 547, 549-52 (7th Cir. 1985).

146. See 4B COLLIER, 1978 ED., *supra* note 132, ¶ 70.98[17], at 1189-90; see also 11 U.S.C. § 363(n) (1988). The section provides:

(n) The trustee may avoid a sale under this section if the sale price was controlled by agreement among potential bidders at such sale, or may recover from a party to such agreement any amount by which the value of the property sold exceeds the price at which such sale was consummated, and may recover any costs, attorneys' fees, or expenses incurred in avoiding such sale or recovering such amount. In addition to any recovery under the preceding sentence, the court may grant judgment for punitive damages in favor of the estate and against any such party that entered into such an agreement in willful disregard of this subsection.

Id.

Some mistakes or infirmities, however, have been held to single-handedly warrant the vacation of a consummated sale. One such defect is the failure to give proper notice of the sale to all interested parties.¹⁴⁷ The lack of proper notice not only stands as a blatant procedural defect, but becomes an issue of fundamental unfairness. As a result, the lack of proper notice is a defect which in itself justifies that a sale be set aside.¹⁴⁸

Section 363 sales are nonetheless properly set aside in many circumstances where they are tainted by fraud, error, or similar defects which in equity would affect the validity of any private transaction.¹⁴⁹ However, the granting of such relief is balanced by the law and policy surrounding rule 60(b) evidence the intention that this type of motion be a limited means for attacking a final judgment.¹⁵⁰ When this policy of restricted application is integrated with the Code's strong policy of preserving the finality of bankruptcy sales, a general practice of upholding regularly-conducted section 363 sales results.¹⁵¹ This works to maintain the stability and integrity of the bankruptcy sale process, which in turn facilitates the efficient administration of bankruptcy estates.

C. A Case Illustration: *In re Edwards*

It is clear that courts retain a strong preference for upholding the finality of bankruptcy sales. This preference pervades judicial decisions, sometimes resulting in the preservation of an otherwise defective sale. *In re Edwards*¹⁵² is one such decision.

Edwards is equally notable for its emphasis on the proper application of to procedural requirements when challenging a bankruptcy sale. Although more attractive, and in fact deceiving issues were presented, the court still managed to approached the case on a fundamental, procedural level. The underlying policy of finality as declared in section 363(m), as well as the restricted application of rule 60(b) when challenging bankruptcy sales, guided the *Edwards* decision.¹⁵³

In *Edwards*, the debtor (Edwards) filed for bankruptcy under chapter 13.¹⁵⁴ Both the first mortgagee and the second mortgagee (Guernsey) filed proof of claims asserting their interest in several pieces of real estate owned by Edwards.¹⁵⁵ After

147. See *infra* notes 172-258 and accompanying text.

148. *Id.*; see also *Jackson v. Pacific Energy Resources (In re Transcontinental Energy Corp.)*, 683 F.2d 326, 328 (9th Cir. 1982).

149. See 4B COLLIER, 1978 ED., *supra* note 132, ¶ 70.98[16]; see, e.g., *Taylor v. Lake (In re Cada Investments, Inc.)*, 664 F.2d 1158, 1162 (9th Cir. 1981); *In re General Insecticide Co.*, 403 F.2d 629, 631 (2d Cir. 1968).

150. See *supra* notes 134-35 and accompanying text.

151. See, e.g., *Musi v. Nigro (In re Homestead Indus., Inc.)*, 138 B.R. 788, 790 (Bankr. W.D. Pa. 1992) (declaring that bankruptcy courts are loathe to tamper with a confirmed sale of estate property).

152. 962 F.2d 641 (7th Cir. 1992).

153. *Id.* at 645.

154. The chapter 13 proceeding was converted to a chapter 7 liquidation proceeding, with a trustee appointed soon after the sale. *Id.* at 642.

155. *Id.* This discussion will not address the adversary complaint filed by Guernsey seeking a determination of whether its second mortgage had priority over other liens against the property formerly

locating a buyer who agreed to purchase the property free and clear of all liens, Edwards petitioned the bankruptcy court to confirm the sale. The court agreed to confirm the sale on the condition that all liens against the property would become liens against the proceeds of the sale. The property was thereafter conveyed to the purchaser, with the sale proceeds satisfying all of the first mortgage, but only \$7,000 of the \$19,000 second mortgage.¹⁵⁶

Guernsey claimed that it never received notice of the sale. In fact, Guernsey did not even learn of the sale until nearly a year later when it received a distribution check from the trustee. The failure to give proper notice resulted when a clerk of the bankruptcy court mistakenly sent notice of the sale to an outdated address originally provided by Guernsey's lawyer at the time of Edward's initial bankruptcy petition. Although the lawyer had since listed his current address on a proof of claim submitted on Guernsey's behalf, the clerk failed to note the change.¹⁵⁷

On appeal to the Seventh Circuit Court of Appeals, Guernsey moved to vacate the bankruptcy court's confirmation of the sale.¹⁵⁸ The *Edwards* court, basing its decision on Guernsey's failure to follow proper procedural guidelines, refused to grant the motion. Instead, the court concluded that the purchaser acquired good title to the debtor's property even though Guernsey did not receive proper notice.¹⁵⁹

In its discussion of the case, the *Edwards* court first recognized that although the rescission of a bankruptcy sale is disfavored, the defective sale could have been vacated if proper procedural steps had been followed.¹⁶⁰ "[T]he Bankruptcy Code would be subject to a serious constitutional attack," reasoned the court, "if it failed to provide notice to lienholders of a sale intended to convey the bankrupt's property free and clear of liens."¹⁶¹ A sale without proper notice is violative of a lienholder's due process rights, and should be declared void if proper steps are taken to rescind it.¹⁶²

However, this conclusion did not determine the case. Although the sale was conducted without appropriate notice, Guernsey failed to properly appeal the confirmation order. Maintaining that an appeal must be timely filed, with the requisite stays obtained pending appeal, the *Edwards* court reminded Guernsey that it had failed to satisfy either of these requirements.¹⁶³ Moreover, once the time for

secured by the second mortgage. This complaint was dismissed by the bankruptcy judge, with the district judge affirming. The appeals court held that a determination of such rights was beyond the jurisdiction of the bankruptcy court because the property had already passed outside that court's control when the property was sold free and clear of all liens. Guernsey's only recourse was to have the sale vacated, and in doing so, recapture the property for the estate. *Id.* at 643.

156. *Id.*

157. *Id.*

158. The bankruptcy court previously dismissed this motion, with the district court upholding the dismissal. *Id.* at 642.

159. *Id.* at 641.

160. *Id.* at 643.

161. *Id.* at 645. See *supra* note 83 and accompanying text.

162. *Edwards*, 962 F.2d at 645; see also *Gekas v. Pipin (In re Met-L-Wood Corp.)*, 861 F.2d 1012, 1017 (7th Cir. 1988) (stating that a judicial sale of property of bankruptcy estate that fails to comply with notice or hearing requirements may be invalid, but is not void).

163. *Edwards*, 962 F.2d at 643; see 11 U.S.C. § 363(m) (1988). See *supra* notes 109-29 and

appeal passed, the sale could only be challenged, if at all, by following the provisions of rule 60(b).¹⁶⁴ Rule 60(b), however, is not a "free-for-all," and because Guernsey failed to file its motion within the general one year limitation, this remedial avenue was also closed.¹⁶⁵

The *Edwards* court explained that the law continually balances competing interests, but in this case the balance tipped heavily in favor of upholding the sale to bona fide purchaser.¹⁶⁶ To take away a person's property (i.e., a lien) without compensation or even notice is "shocking," but the property rights of a bona fide purchaser also deserve consideration.¹⁶⁷ To upset the bankruptcy sale would violate a strong policy of finality while infringing upon the principle that a bona fide purchaser should not, years later, lose all right in property due to an antiquated "slip-up."¹⁶⁸ Rule 60(b) must be interpreted in light of this policy.¹⁶⁹

In weighing the policy of finality of a bankruptcy sale to a bona fide purchaser against the due process rights of a lienholder, *Edwards* held that a line must be drawn — even if it comes at the expense of a valid lienholder.¹⁷⁰ This demonstrates that a court's commitment to upholding the finality of a consummated bankruptcy sale may outweigh the policy of avoiding a tainted sale, even when the sale's defect arose from the lack of proper notice.¹⁷¹ *Edwards* is equally instructive, however, for its comprehensive analysis of the procedural requirements encountered when challenging a bankruptcy sale. Procedural requirements must always be satisfied when conducting a section 363 sale, but as demonstrated in *Edwards*, this may be even more true when challenging the same.

III. Sales Conducted Without Proper Notice: Varied Treatments

Appearing more than 130 times in the Bankruptcy Rules, the term "notice" and its related procedures are a cornerstone of bankruptcy practice.¹⁷² As employed in the context of a section 363 sale, the notice requirement is used to balance a debtor's rights against the guarantee that creditors and other interested parties will not be deprived of life, liberty, or property without due process of law.¹⁷³ Therefore, when notice of an impending section 363 sale is not given, such failure

accompanying text.

164. *Edwards*, 962 F.2d at 643.

165. *Id.* at 644. Guernsey argued that the order was "void" and therefore within rule 60(b)(4) which has no time limit. The court rejected this argument, stating that a denial of due process is for the most part treated like any other legal error, and is waived if not pressed. *Id.* See *supra* note 135.

166. *Edwards*, 962 F.2d at 643. See *supra* note 127.

167. *Edwards*, 962 F.2d at 645.

168. *Id.*

169. *Id.*

170. *Id.*

171. But see *infra* notes 179-99 and accompanying text.

172. See *In re F.A. Potts & Co.*, 86 B.R. 853, 860-61 (Bankr. E.D. Pa. 1988).

173. *Id.* (stating the notice requirement is fulcrum used to balance debtors' Title 11 protections against the creditors' Fifth Amendment guarantees).

not only results in a violation of the Code's procedural guidelines, but likely the property interest holder's due process rights as well.¹⁷⁴

Despite the importance of the notice requirement in the context of a bankruptcy sale, the failure to give adequate notice has been noted as "by far the most frequent mistake or infirmity held to warrant vacating a confirmed sale."¹⁷⁵ Nevertheless, judicial remedies for failing to provide the requisite section 363(b) notice have not been uniform. The differing treatments fall into two identifiable categories.

The most common remedy has been to set the sale aside or treat the sale as voidable, typically at the option of the creditor or interested party who failed to receive notice of the sale.¹⁷⁶ This more conventional approach demands strict adherence to the Code's procedural requirements; a sale conducted without proper notice is viewed as a taking of one's property in direct violation of due process rights.¹⁷⁷

Other courts, however, have molded alternative remedies when dealing with a section 363 sale conducted in violation of applicable notice requirements.¹⁷⁸ This second line of reasoning has recently gained added favor as it is a more flexible remedy, balancing the conflicting equitable and economic interests of those parties affected by the sale. Under this less orthodox approach, an otherwise defective sale will be upheld when such treatment is in the best interest of all parties involved.

A. Decisions Declaring Defective Sales Void

Decisions from the First and Fifth Circuits form a representative sample of courts which choose to follow an approach demanding adherence to the Code's strict notice requirements. The bankruptcy, district, and appellate courts in these circuits generally choose to declare a sale void or voidable if appropriate notice is not given to all interested parties. Such treatment works to avoid an intrusion on the due process rights of interested parties which would otherwise result if the sale were allowed to stand.

In *M.R.R. Traders, Inc. v. Cave Atlantique*,¹⁷⁹ the First Circuit Court of Appeals upheld the bankruptcy judge's power to cancel a defective sale, declaring that "fair procedure produces a more equitable sale."¹⁸⁰ The sale was set aside because the notice of the sale failed to satisfy the specific requirements outlined in rule 2002(g) of the Bankruptcy Rules.¹⁸¹

174. See *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950) (citing *Milliken v. Meyer*, 311 U.S. 457 (1940)) ("An elementary and fundamental requirement of due process in any proceeding which is to be accorded finality is notice reasonably calculated, under all circumstances, to apprise interested parties of the pendency of the action and afford them an opportunity to present their objections."). See *infra* notes 179-99, 229-57 and accompanying text.

175. *In re Chung King, Inc.*, 753 F.2d 547, 551 (7th Cir. 1985).

176. See *infra* notes 179-99 and accompanying text.

177. See *infra* notes 179-99 and accompanying text.

178. See *infra* notes 200-28 and accompanying text.

179. 788 F.2d 816 (1st Cir. 1986).

180. *Id.* at 819.

181. *Id.*

M.R.R. Traders arose after the debtor, a wine shop (Cave Atlantique), granted its landlord (DiGiovanni) an option to purchase its liquor license for \$11,000. However, in hopes of getting a higher price for the license, Cave Atlantique, with the bankruptcy court's approval, rejected the contract.¹⁸² *M.R.R. Traders, Inc.*, (*M.R.R.*), then offered to purchase the license for \$18,000.¹⁸³

In adherence to proper bankruptcy procedure, a notice of the proposed sale was prepared and allegedly mailed to all interested parties. The bankruptcy court then approved the sale to *M.R.R.*, but DiGiovanni petitioned the bankruptcy court to reconsider the sale, asserting that his attorneys had just learned of *M.R.R.*'s offer.¹⁸⁴

Following a hearing, the bankruptcy court determined that there had in fact been a mistake in sending out the notice. Although notice had been sent to DiGiovanni himself, Cave Atlantique had failed to send notice to DiGiovanni's attorneys. Because DiGiovanni's attorneys had received all other paperwork concerning the bankruptcy proceeding, the court determined that notice of the sale should likewise have been sent to the attorneys. The bankruptcy court set aside the original sale due to inadequate notice,¹⁸⁵ but district court later reversed this ruling.¹⁸⁶

On appeal to the First Circuit Court of Appeals, the *M.R.R. Traders* court addressed the question of whether the original bankruptcy sale was sufficiently tainted by fraud, unfairness, or mistake, so as to justifying the bankruptcy court's decision to set the sale aside. The court determined that in this case, the questions of "unfairness" and "due notice" became a single issue as it was the inadequate notice which arguably made the sale unfair.¹⁸⁷ DiGiovanni had intended to bid on the license, but was robbed of that opportunity because of an oversight on the part of Cave Atlantique's attorneys.¹⁸⁸ Therefore, because of the lack of notice and resulting unfairness, the bankruptcy court properly set the sale aside.¹⁸⁹

The *M.R.R. Traders* court went beyond a mere discussion of the implicit unfairness of the sale, resting its holding on the bankruptcy court's explicit findings that Cave Atlantique and *M.R.R.* failed to satisfy the requirements of rule 2002(g).¹⁹⁰ This rule requires notice to be mailed to all creditors and interested parties at the addresses provided on the List of Creditors, or to a different address if one is stated in a Proof of Claim.¹⁹¹ Because the name and address of DiGiovanni's counsel were stated in a Proof of Claim,¹⁹² notice of the sale should

182. *Id.* at 817; see also 11 U.S.C. § 365(a) (1988). The subsection provides: "Except as provided in sections 765 and 766 of this title and in subsections (b), (c), and (d) of this section, the trustee, subject to the court's approval, may assume or reject any executory contract or expired lease of the debtor." *Id.*

183. *M.R.R. Traders*, 788 F.2d at 817.

184. *Id.* at 819.

185. *Id.* A second sale by public auction was then held on the spot, where DiGiovanni purchased the license for \$40,000. *Id.* at 817.

186. *Id.* at 817-18.

187. *Id.* at 818.

188. *Id.*

189. *Id.* (citing *In re Times Sales Fin.*, 445 F.2d 385, 386-87 (3d Cir. 1971)).

190. *Id.* at 819; see also FED. R. BANKR. P. 2002(g).

191. *M.R.R. Traders*, 788 F.2d at 819. See *supra* note 77-82 and accompanying text.

192. The name and address actually appeared on a hybrid form; a one page document called a

have been sent to that address.¹⁹³ *M.R.R. Traders* thus demonstrates an approach which places great importance on the adherence to the Code's procedural requirements. The court thus regarded the defective sale as void from the outset because the failure to give proper notice violated the court's concept of an equitable sale.¹⁹⁴

The importance of satisfying notice requirements as a prerequisite to a valid sale under section 363 is further demonstrated in *Murphy v. Malone (In re Century Steel, Inc.)*.¹⁹⁵ In *In re Century Steel*, the president and sole shareholder of the debtor corporation (Murphy) arranged to purchase a vehicle from the bankruptcy estate. Murphy later paid \$2000 in cash and agreed to assume the first lien on the vehicle.¹⁹⁶

Although the trustee planned to file the necessary motions to obtain court approval of the sale, the vehicle was destroyed in a collision before this could be done. Because there was no insurance on the vehicle, Murphy attempted to avoid the sale, claiming that it was his understanding that his deposit merely gave him the option to later purchase the vehicle. In defense, the trustee asserted that because Murphy fully intended to purchase the vehicle, conditioned only upon court approval, the sale should be upheld.¹⁹⁷

The *Century Steel* court quickly dismissed the trustee's contention, maintaining that the sale had not been properly executed, and therefore any risk of loss remained with the trustee.¹⁹⁸ The court looked to the text of section 363, stating that the trustee did not have the authority to sell until proper "notice and a hearing" had been given; until that time, there could be no sale.¹⁹⁹

"Proof of Claim and Power of Attorney." In spite of M.R.R.'s protests, the court ruled that this form was sufficient to bring it within the literal wording of rule 2002(g). *M.R.R. Traders*, 788 F.2d at 819.

193. *Id.* at 818.

194. *Id.* at 819; see also *Felts v. Bishop (In re Winstead)*, 33 B.R. 408, 410 (M.D.N.C. 1983) (holding that when a bidder to a sale received inadequate notice of a hearing concerning the sale of the property, the bankruptcy court's approval of the sale should be reversed). But see *Paris Mfg. Corp. v. Ace Hardware Corp. (In re Paris Indus. Corp.)*, 132 B.R. 504, 510 (D. Me. 1991) (upholding the sale of a debtor's assets as "free and clear" of all claims even though proper notice to all interested parties may have been lacking; holding based on the premise that the claimants were in no way prejudiced by lack of notice, and that they had made no showing that, if they had been notified, they could have made any valid arguments to dissuade the bankruptcy court from issuing its order that the assets be sold free and clear of all claims). Although *Paris Industries* seems to place the First Circuit in line with those jurisdictions which favor a balancing test in determining whether a sale without notice should be declared void, it should not, in the author's view, be given excessive deference. Rather than focusing on the issue of proper notice, the court's analysis focused on the legitimacy of the products liability claim at issue and the bankruptcy court's power to dispose of that claim. See *id.* at 508-10. See *infra* notes 200-19 and accompanying text.

195. 56 B.R. 268 (Bankr. M.D. La. 1985).

196. *Id.* at 269.

197. *Id.* at 270.

198. *Id.*

199. *Id.* The court went on to address the issues arising from the determination that there was not a valid sale, specifically the liability for the damages arising from the wreck. *Id.* at 270-71.

While *Century Steel* supports the view that a seller must always adhere to the Code's procedural requirements, the decision does more to demonstrate the limitations of such a rigid approach. While one may see the avoidance of a defective bankruptcy sale as a tool to be utilized for the benefit of the estate, this does not necessarily hold true. Such an approach can also be used as a sword to avoid a sale, even if to uphold the sale would be beneficial to the estate and its creditors.

B. Decisions Declaring Defective Sales Void: A Summary

By refusing to uphold the validity of sales conducted without proper notice, selected courts in the First and Fifth Circuits have embraced a view which advocates adherence to the Code's provisions while encouraging respect for interest holders' due process rights. This approach fosters an element of predictability, and in that predictability, a degree of fairness as parties involved in bankruptcy sales are treated consistently under established terms.

Due to this consistency, property may be purchased with a full understanding that the legitimacy of the sale may be attacked. However, there will also be the assurance that any such attack is limited in time and scope by established procedural guidelines. This encourages parties to act in a confident and economically efficient manner in relation to bankruptcy sales, ensuring the marketability of the property involved.

However, while a degree of fairness is secured by a strict adherence to procedural guidelines, an overly rigid approach can sometimes work as a disadvantage to the estate and interested parties. Such a case may arise when an insignificant or inoffensive technical defect is used to invalidate an otherwise desirable sale. With an understanding that imperfections are far too common in complicated legal transactions, an all-or-nothing approach can sometimes be detrimental to the bankruptcy estate.

C. Decisions Utilizing a Balancing Test

In recent years, an emerging trend has been illustrated by courts which mold, or perhaps more appropriately, disregard, the Code's procedural requirements in order to achieve a desired result. Certain bankruptcy courts in the Third²⁰⁰ and Sixth Circuits have issued holdings which illustrate this approach. Although case law in these jurisdictions is not unanimous on this issue, recent decisions have worked to substantiate a developing approval of this flexible approach.

200. It is acknowledged that a survey of Third Circuit case law reveals decisions which declare sales invalid if proper notice is not given. See, e.g., *In re F.A. Potts & Co.*, 86 B.R. 853, 859, 863 (Bankr. E.D. Pa. 1988), *order aff'd* by, 93 B.R. 62, 73 (Bankr. E.D. Pa. 1988) (stating that sales held without proper notice unequivocally invalid; the court determined that the notice to creditors of a judicial sale was defective and thus the sale should be declared violative of the creditor's rights to due process and voidable at the option of the creditor); see also *Esposito v. Title Ins. Co. (In re Fernwood Mkts.)*, 73 B.R. 616 (Bankr. E.D. Pa. 1987); *Zalevsky v. Steele*, 78 B.R. 100 (W.D. Pa. 1987). However, recent decisions, some specifically denouncing the above view, form a good illustration of the less rigid balancing approach. See *infra* notes 201-19 and accompanying text.

In *In re Cavalieri*²⁰¹, the United States Bankruptcy Court for the Eastern District of Pennsylvania concluded that a balancing approach should be employed when considering the validity of a section 363 sale conducted without proper notice.²⁰² After an exhaustive analysis of relevant case law, the *Cavalieri* court chose to disregard the uncompromising view that a sale consummated without proper notice is presumed to be void or voidable. Rather, it adopted the more flexible approach which fashions remedies based upon the unique factual scenario underlying each case.²⁰³

Cavalieri involved the sale of an automobile by a chapter 13 debtor, allegedly free and clear of all liens. A security interest in the automobile, however, had been mistakenly released.²⁰⁴ In an attempt to salvage the situation, the previously secured party (CoreStates) requested that the debtor enter into a stipulation allowing relief from the automatic stay so the encumbrance could be reinstated. However, the debtor had already sold the vehicle to a friend.²⁰⁵

CoreStates then filed a motion seeking to reinstate the lien. Acknowledging that the Code gives a chapter 13 debtor the powers of a trustee, including the power to sell property of the estate under section 363, CoreStates asserted that notice and the opportunity for a hearing must nevertheless be provided before a sale takes place. CoreStates claimed that the failure to give notice of the sale was in direct violation of its due process rights and the Code, requiring that the sale be set aside and the lien reinstated.²⁰⁶

The *Cavalieri* court first noted that although judicial remedies for the failure to provide the requisite section 363(b) notice are not uniform, the most common remedy has been to set the sale aside or treat it as voidable at the option of the creditor.²⁰⁷ However, when a seller fails to give notice as dictated by the Code, courts have frequently molded remedies based upon the facts before them. Therefore, after a thorough examination of relevant case law in the Third Circuit as well as other circuits,²⁰⁸ the *Cavalieri* court adopted the more flexible, balancing approach.²⁰⁹

Under this balancing approach, a court must undergo a detailed consideration of the specific facts and the underlying controversy presented in the case at hand.²¹⁰

201. 142 B.R. 710 (Bankr. E.D. Pa. 1992).

202. *Id.* at 716.

203. *Id.*

204. This mistake occurred when the secured party attempted to file an amended Proof of Claim listing the asset as its collateral, but accidentally delivered a release of the title marked "paid." *Id.* at 712. The debtor stated that he thought the lien had been paid by one of his wealthy friends who had become aware that he was "personally bankrupt." *Id.*

205. *Id.* at 714.

206. *Id.*

207. *Id.* at 715.

208. See, e.g., *In re Lundy* 110 B.R. 300 (Bankr. N.D. Ohio 1990); *In re New York City Shoes, Inc.*, 89 B.R. 479 (Bankr. E.D. Pa. 1988), *rev'd on other grounds*, No. CIV.A.90-2976, 1990 WL 126121 (E.D. Pa. 1990); *Tigue v. Steger (In re Tigues)*, 82 B.R. 724 (Bankr. E.D. Pa. 1988).

209. *Calvalieri*, 142 B.R. at 715-16.

210. *Id.* at 716.

One significant factor commonly addressed when reconsidering a section 363 sale is whether the debtor's estate would be deprived of a valuable asset if the sale were allowed to stand. However, in *Cavalieri*, the manner in which the sale was carried out determined the court's decision.²¹¹

Pointing to the fact that the vehicle had been sold to a friend shortly after title had been improperly cleared, the *Cavalieri* court determined that the sale constituted a "sweetheart deal" and should not be allowed to stand.²¹² Considering the equities surrounding the transaction, the *Cavalieri* court concluded that the balance tipped in favor of the creditor and the estate, rather than the purchaser. The court therefore set the sale aside.²¹³

Cavalieri illustrates that although the balancing approach is generally viewed as a method aimed at the realization of equity through the preservation of otherwise invalid sales, it can also be used to achieve fairness by rejecting unacceptable sales. The balancing approach merely determines the relation and status of the interests involved; whether the sale is avoided or preserved depends on an equitable consideration of the interests involved.

A balancing approach was again employed in *In re New York City Shoes, Inc.*²¹⁴ Here, the chief financial officer of a reorganizing corporate debtor sold 30,000 pairs of "warehouse" shoes without court approval or the requisite notice to interested parties.²¹⁵ Although the failure to provide proper notice could have been used to render the sale void, this was not the result in *New York City Shoes*.²¹⁶

The bankruptcy court in *New York City Shoes*, weighing the interests and concerns of the parties involved, chose to uphold the sale despite its obvious defect.²¹⁷ The court determined that any relief provided to the creditors should be based on the "estimated potential damage to the estate" as a result of the lack of notice.²¹⁸ The court refused to vacate the sale, instead assessing damages as the

211. *Id.* at 717.

212. *Id.*

213. *Id.* at 716-17. The factors considered were: (1) the interests of the debtor, since there was no evidence that he knew of the unauthorized nature of the sale, (2) the interests of the debtor's estate, (3) the interests of the creditors and other interested parties, and (4) the nature of debtor's unauthorized action.

214. 89 B.R. 479, 484 (Bankr. E.D. Pa. 1988), *rev'd on other grounds*, No. CIV.A.90-2976, 1990 WL 126121 (E.D. Pa. Aug. 23, 1990).

215. *Id.* at 481.

216. Note that *New York City Shoes* does not follow those Third Circuit decisions which declare a sale voidable at the option of creditor. Despite the fact that the creditors' committee in *New York City Shoes* did not seek to have the sale vacated, which may support the decision to uphold the sale, the court nevertheless approached the case from a different perspective. The decision to uphold the sale was based upon a balancing of the interests involved, giving monetary relief to those whose interests were negatively affected by the sale. When a sale is viewed as one merely voidable at the option of the creditors, it remains as such until a challenge is brought. If that were the case, the court would not have engaged in a balancing of the interests; the sale would have been vacated or implicitly upheld due to the absence of any challenge.

217. *New York Shoes*, 89 B.R. at 481.

218. *Id.* at 484. A witness testified that had he received notice of the sale he would have bid on the shoes, and that he believed the shoes were worth between \$2.75 and \$3.50 per pair. Based partially on

difference between the amount the shoes would have otherwise brought and the amount actually received.²¹⁹

The relief granted in *New York City Shoes* thus focused on the economic loss which the creditors suffered as a result of the defective sale. This monetary form of relief compensated for any benefit which would have been received had the transaction been carried out according to the procedural and economic expectations of the injured party. Such an economic approach is attractive because it compensates the injured party for any benefit reasonably expected while saving the court and the estate the burden of having to vacate the completed sale. Problems can arise, however, when the loss cannot be measured, or when the estate does not have the resources to compensate the injured party for the resulting injury.

The United States Bankruptcy Court for the Eastern District of Pennsylvania also employed a balancing test to uphold a defective bankruptcy sale in *In re Lundy*.²²⁰ In *Lundy*, the debtors sold a residential property to a third party without serving proper notice upon the mortgagee of the property, the Federal National Mortgage Association (FNMA). The sale, which had been approved by the bankruptcy court, produced a selling price sufficient to cover the first mortgage, but only part of FNMA's second mortgage.²²¹

The *Lundy* court concluded that although FNMA did not receive proper notice, the sale should not be set aside.²²² The court stated that the debtors and their creditors no longer had a continuing interest in the property because it was now owned by a third party who had encumbered it with a fresh mortgage. Moreover, the property was no longer part of the debtor's estate over which the court had ready access or control.²²³

Despite the absence of any wrongdoing on FNMA's part, the *Lundy* court maintained that the consummation of the sale vested new interests in the purchaser of the property.²²⁴ Because the third party's new interest in the property outweighed the interest previously held by FNMA, the court reasoned that the sale could no longer be set aside.²²⁵ By refusing to revoke the flawed sale, the *Lundy* court effectively washed its hands of the transaction. Any desired relief would have to be pursued against the debtor, individually.²²⁶

this testimony, the court determined the shoes would have sold for at least \$1.00 per pair. The court assessed damages at \$18,000, the difference between the court-determined figure of the 30,000 pairs of shoes (\$30,000) and the amount actually received for the shoes (\$12,000). See also *In re Tigue*, 82 B.R. 724, 736 (Bankr. E.D. Pa. 1988) (where an attorney for a debtor who was incarcerated in a mental institution purchased property from the bankruptcy estate without providing the debtor notice; the unauthorized sale was not set aside, but the attorney was required to reimburse the debtor for any personal financial benefit gained from the transaction).

219. *New York Shoes*, 89 B.R. at 484.

220. 110 B.R. 300 (Bankr. N.D. Ohio 1990).

221. *Id.* at 301.

222. *Id.* at 301-02.

223. *Id.* at 304.

224. *Id.*

225. *Id.*

226. *Id.*

Lundy exemplifies an extreme result which can be produced when utilizing the balancing approach. By basing its ruling exclusively on a determination of the status of the parties' interests, at a time subsequently removed from that of the sale in question, the newly vested rights were given precedence over the rights held by the mortgagee at the time of the sale. This outcome seems to disregard the principle upon which the balancing approach is based: the equitable treatment of all parties' interests. The result in *Lundy* instead approaches a blatant infringement of the due process rights of the mortgage holder.²²⁷

D. Decisions Utilizing a Balancing Approach: A Summary

The relief offered by courts utilizing a balancing approach, while possessing some visible benefits, has its share of disadvantages. The benefit most likely perceived is flexibility. This allows a court to tailor its relief to the specific factual situation, allowing for a more equitable resolution of a dispute surrounding a tainted bankruptcy sale. The use of the balancing approach may also prevent the avoidance of a slightly imperfect sale simply because of an insignificant, technical error in its consummation. It can also be used to ensure the avoidance of a sale when it is in the best interest of all parties involved, or if equity so demands.

The flexibility inherent in the balancing approach inevitably leads to its leading drawback — uncertainty. In a jurisdiction holding that a sale conducted without proper notice is void or voidable, there is at least some degree of predictability in a court's probable treatment of such a defective bankruptcy sale. However, under the balancing approach, the standing of an imperfect sale may not be known until a court issues its final decision. This leaves the parties to the transaction, as well as parties who are indirectly interested or affected by the transaction, in a state of uncertainty. As a consequence, future bankruptcy sales, or other transactions which may be legally or economically efficient for the estate, may be frustrated or avoided altogether.²²⁸

IV. The Tenth Circuit

Consistent with the Tenth Circuit's generally inadequate body of commercial case law, cases discussing the lack of notice in section 363 sales are predictably absent. There are cases, however, while not directly on point, which are helpful in discerning the Tenth Circuit's probable treatment of a bankruptcy sale conducted without proper notice. These cases include a pre-Code decision which vacates a bankruptcy sale conducted without notice, and a pair of cases addressing the lack of notice in relation to the confirmation of a chapter 11 reorganization plan. These cases send a strong message that the failure to give proper notice violates an interested party's due process rights and will not be excused.

227. See *supra* notes 179-99 and accompanying text.

228. A prime example arises when a title examiner is hesitant, or refuses altogether, to issue an opinion guaranteeing the marketability of property acquired through a bankruptcy sale based on the uncertainty surrounding the finality of the sale.

A. The Tenth Circuit: Pre-Code Decision

In the pre-Code decision of *Mason v. Ashback*,²²⁹ the Tenth Circuit Court of Appeals vacated a bankruptcy sale which had been carried out without giving creditors notice of the transaction. The court held that the lack of notice in conducting the sale worked a fraud on the creditors, and therefore, should be set aside.²³⁰

The bankruptcy proceeding in *Mason* had been pending for a period of years before a chose in action was tardily added to the estate's inventory of assets. When the trustee petitioned the court for the sale of the asset, only the bankrupt (Ashback) and the debtor of the chose in action (Mason) submitted bids. Ashback's lower bid was accepted, and the sale ordered and confirmed. Mason challenged the bankruptcy court's confirmation of the sale, but the district court denied the petition.²³¹

On appeal to the Tenth Circuit Court of Appeals, the *Mason* court first recognized that a bankruptcy court, as a court of equity, could set aside an order of sale either before or after confirmation when it appears that the sale was entered through mistake, inadvertence, or improvidence.²³² However, the inadequate price received from Ashback would not, in itself, be enough to set the confirmed sale aside.²³³

The *Mason* court therefore turned to the record, noting that there was no evidence that notice of the sale had ever been given to the creditors.²³⁴ Moreover, the court

229. 383 F.2d 779 (10th Cir. 1967).

230. *Id.* at 780.

231. *Id.*

232. *Id.*

233. *Id.* Although inadequacy of price may sometimes be enough to avoid the confirmation of a sale, standing alone it is an insufficient ground for setting aside a sale; unless the inadequacy is so great in itself to raise a presumption of fraud or to shock the conscience of the court. See 4B COLLIER, 1978 ED., *supra* note 132, ¶ 70.98[17], at 1182, 1187, 1192. This is because the standard of review for setting aside a sale based on inadequate price is stricter than that applied in a direct attack upon an original confirmation of a sale. *Id.* When attacking a confirmation of a sale, the governing consideration is to obtain the best price for the bankruptcy estate, whereas in an appellate attack, there is greater emphasis upon preserving the finality of the sales. See *In re Chung King, Inc.*, 753 F.2d 547, 549 (7th Cir. 1985); *In re Whitney-Forbes, Inc.*, 770 F.2d 692, 696 (7th Cir. 1985); *In re Webcor, Inc.*, 392 F.2d 893, 898 (7th Cir.), *cert. denied*, 393 U.S. 837 (1968). See *supra* notes 127-28. Adequacy of price is determined by examining the price at the time of the sale and not at the time of the attack on the confirmation of the sale. See, e.g., *United States v. Salerno*, 932 F.2d 117, 123 (2d Cir. 1991); *Smith v. Juhan (In re Smith)*, 311 F.2d 670, 673 (10th Cir. 1962); *In re Todem Homes, Inc.*, 51 B.R. 883, 888 (Bankr. S.D.N.Y. 1985). A subsequent offer of an excessively higher price may sometimes require that a sale be vacated if the amount of that offer indicates that the initial sale price was "grossly inadequate." See, e.g., *In re Chung King, Inc.*, 753 F.2d 547, 550 (7th Cir. 1985); *In re Snyder*, 74 B.R. 872, 878 (Bankr. E.D. Pa. 1987); *In re F.A. Potts & Co.*, 93 B.R. 62, 65 (E.D. Pa. 1988); *In re Todem Homes, Inc.*, 51 B.R. 883, 888 (Bankr. S.D.N.Y. 1985). Gross inadequacy is said to exist when apart from situations involving fraud or unfairness, there is a substantial disparity between the highest bid and the appraised or fair market value, and there is a reasonable degree of probability that a substantially better price will be obtained by a resale. See *In re Muscongus Bay Co.*, 597 F.2d 11, 12 (1st Cir. 1979); *Munro Drydock, Inc. v. M/V Heron*, 585 F.2d 13, 15 (1st Cir. 1978).

234. *Mason*, 383 F.2d at 780.

underscored its observation that there was no justification for the lack of notice; the asset would not have suffered any appreciable reduction in value if it were not sold quickly and the estate was not in any danger of suffering substantial prejudice if the sale was not expedited by dispensing with all notice.²³⁵ These factors, combined with the inadequate price received for the asset, indicated an apparent unfairness or impropriety which justified the avoidance of the sale.²³⁶

The *Mason* court concluded that the bankruptcy sale carried out in contravention of mandated procedural guidelines worked an illegal fraud on the creditors and should be viewed as "wholly illusory."²³⁷ The court thus declared notice to be an absolute requirement which cannot be justified in hindsight, while refusing to utilize any form of an equitable balancing test as a means to excuse the sale's deficiency. Nevertheless, *Mason's* standing as a reasonably aged, pre-Code decision leaves the Tenth Circuit's current posture uncertain.

B. The Tenth Circuit: Decisions Under the Code

Despite the absence of current case law under the Code clarifying the Tenth Circuit's position on the treatment of section 363 sales conducted without proper notice, several analogous cases are helpful. These cases, addressing the failure to provide appropriate notice to creditors during a reorganization proceeding, further demonstrate the Tenth Circuit's adherence to procedural requirements, while shunning the adoption of an equitable balancing approach.

In *Reliable Electric Co. v. Olson Construction Co.*,²³⁸ the debtor (Reliable) appealed a final order of the bankruptcy court which excluded an unsecured creditor's (Olson) claim from Reliable's confirmed plan of reorganization. The bankruptcy court, in refusing to discharge Olson's claim, determined that although Olson possessed actual knowledge of the reorganization proceeding, it did not receive adequate notice of the confirmation hearing.²³⁹

This dispute arose from Reliable's voluntary chapter 11 reorganization. Although a schedule of creditors was submitted, which included Olson's unsecured claim, Olson's claim was mistakenly listed as an "Accounts Receivable" rather than as a "Creditor."²⁴⁰ The bankruptcy court thereafter mailed notice to the scheduled creditors, informing them of the deadline for filing acceptances or rejections of Reliable's chapter 11 plan. A confirmation hearing was held, after which the bankruptcy court again mailed notice of the confirmation order and discharge to the scheduled creditors. Because Olson was not listed as a scheduled creditor, it did not receive any of these notices.²⁴¹

The *Reliable* court's analysis rested on the United States Supreme Court's repeated emphasis that an interested party's due process rights should always be respected;

235. *Id.* See *supra* note 93.

236. *Mason*, 383 F.2d at 780.

237. *Id.*

238. 726 F.2d 620 (10th Cir. 1984).

239. *Id.* at 620-21.

240. *Id.* at 621.

241. *Id.*

that notice should be given so an interested party can present its objections to any proceeding to be accorded finality.²⁴² The *Reliable* court noted that as specifically applied to bankruptcy proceedings, the Supreme Court even held that a creditor who has general knowledge of a debtor's reorganization proceeding has a "right to assume" that he will receive all the notices required by statute before his claim is forever barred.²⁴³ Olson was therefore reasonable in expecting the same formal notice of the confirmation hearing as was sent to the other identifiable creditors.²⁴⁴ When a property interest is at stake, all creditors and interested parties must be guaranteed the opportunity to protect their interests.²⁴⁵ Deprived of the opportunity to be heard at the confirmation hearing, Olson was denied due process of law.²⁴⁶

Despite *Reliable's* contention that Olson was still subject to the confirmed plan,²⁴⁷ the court held that the discharge of a claim without reasonable notice of the confirmation hearing violated the Fifth Amendment to the United States Constitution.²⁴⁸ Consequently, Olson could not be bound by the plan, nor the discharge allowed.²⁴⁹

The adherence to procedural requirements and a respect for the due process rights interested parties in a bankruptcy proceeding was again demonstrated in the Tenth Circuit decision of *Sheftelman v. Standard Metals Corp.*²⁵⁰ In *Sheftelman*, certain bondholders were not given notice of the deadlines for filing proofs of claims based on the rationale that notice need only be given to "known" creditors. The bankruptcy court reasoned that it would unduly complicate the proceedings if it required notice to be sent to all bondholders.²⁵¹

The Tenth Circuit Court of Appeals rejected this assertion, declaring that the bondholders were in fact "known" to the debtor.²⁵² The debtor therefore had a duty to amend its schedules to include these bondholders as claimants.²⁵³ Moreover, because rule 2002(a) requires notice of the deadline for filing proofs of claims to

242. *Id.* at 622; see also *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950).

243. See *supra* note 242. See *City of New York v. New York, N.H. & H.R. Co.*, 344 U.S. 293, 297 (1953); *In re Intaco Puerto Rico, Inc.*, 494 F.2d 94, 99 (1st Cir. 1974); *In re Harbor Tank Storage Co.*, 385 F.2d 111, 111 (3d Cir. 1967). But see *Zidell, Inc. v. Forsch (In re Coastal Alaska Lines)*, 920 F.2d 1428 (9th Cir. 1990) (holding that due process rights of unscheduled creditor, who had knowledge of chapter 7 case but did not receive actual notice of claims bar date, were not violated); *Dolinger v. Poskanzer (In re Poskanzer)*, 146 B.R. 125, 132-33 (D.N.J. 1992) (holding that the rationale upon which *Harbor Tank* is based has been obviated by passage of the Code).

244. *Reliable*, 726 F.2d at 622.

245. *Id.*

246. *Id.*

247. *Reliable* argued that 11 U.S.C. § 1141(d) discharged all claims, whether a Proof of Claim had been filed, whether such claim was allowed, or whether the claimholder had accepted the plan. *Id.* at 622-23. *Reliable* further claimed that an "all-encompassing" discharge was necessary to meet the purpose of reorganization and to give the debtor a "fresh start." *Id.*

248. *Id.* at 623; see also 5 COLLIER, *supra* note 9, ¶ 1141.01[b], at 1141-12.

249. *Reliable*, 726 F.2d at 623.

250. 839 F.2d 1383 (10th Cir. 1987).

251. *Id.* at 1385.

252. *Id.*

253. *Id.*

be given to "all creditors,"²⁵⁴ any failure to satisfy this requirement violates an interested party's right to due process.²⁵⁵

The *Sheftelman* court therefore concluded that the limitation of notice to only those creditors listed by the debtor, even after other claims became known, was clearly erroneous.²⁵⁶ The bankruptcy court had a responsibility to give every interested party an opportunity to present their claims in the proceedings; the failure to do so violated the Code's procedural requirements and the interest holder's right to due process.²⁵⁷

C. The Tenth Circuit Decisions: A Summary

While the Tenth Circuit has no case law directly addressing the lack of notice in the context of a section 363 sale, *Reliable* and *Sheftelman* stand in support of the view espoused in the pre-Code *Mason* decision — that bankruptcy sales conducted without proper notice should be declared void. In light of these decisions, it appears that the Tenth Circuit will require strict adherence to procedural requirements, including that of proper notice, when conducting a bankruptcy sale. Consequently, the employment of a balancing test as a means of upholding an otherwise defective section 363 sale will likely be rejected.

V. Conclusion

The purpose of a bankruptcy proceeding is to provide a systematic liquidation or reorganization of a debtor's estate, ultimately giving the debtor a fresh start once the proceeding has concluded. Section 363 of the Code is a valuable tool utilized to reach this end.

Section 363 sales are guided by a myriad of requirements, one of the more important being that of proper notice. Whether notice to an interested party is merely inadequate or completely absent, the resulting sale is tainted with a potentially fatal flaw.

Courts have traditionally declared sales conducted without proper notice void or voidable at the option of an affected interest holder. Recent decisions, however, have introduced an emerging trend which tends to validate defective sales when, under the circumstances of the specific case, to do so is in the best interests of the parties involved.

A court may therefore choose between two views: a traditional view which favors predictability and preservation of an interest holder's right to due process, or a balancing approach which strives for an efficient and equitable result. The Tenth Circuit, with its commitment to the procedural and due process rights of interest

254. See *supra* notes 77-78.

255. *Sheftelman*, 839 F.2d at 1386; see also *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 314 (1950).

256. *Sheftelman*, 839 F.2d at 1387.

257. *Id.*

holders, will likely reject the balancing approach, declaring void any sale conducted without proper notice.

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